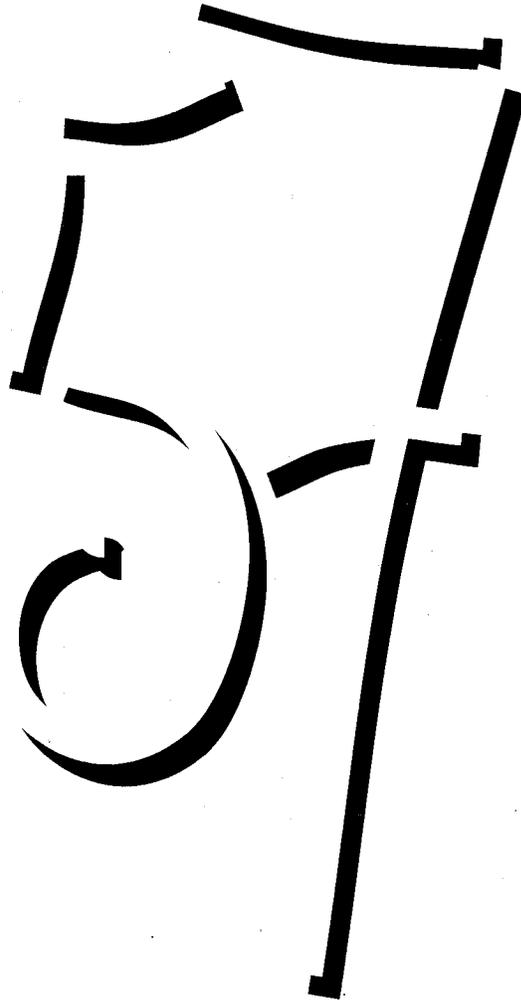


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C E P A L

REVIEW



UNITED NATIONS



UNITED NATIONS

ECLAC

ECONOMIC COMMISSION
FOR LATIN AMERICA AND
THE CARIBBEAN

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(...)	Three dots indicate that data are not available or are not separately reported.
(—)	A dash indicates that the amount is nil or negligible.
	A blank space in a table means that the item in question is not applicable.
(-)	A minus sign indicates a deficit or decrease, unless otherwise specified.
(.)	A point is used to indicate decimals.
(/)	A slash indicates a crop year or fiscal year, e.g., 1970/1971.
(-)	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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The United Nations *and ECLAC* at the half-century mark *of the Organization*

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I

Fifty years ago, a broad and representative group of countries tried for the second time in this century to set up a world organization to try to banish the scourge of war and promote international cooperation. The first attempt—the League of Nations—had foundered in the stormy waters that were to lead to the greatest cataclysm in world history. The second effort—the United Nations—has so far resisted different but equally severe trials, notably the so-called “Cold War”.

Completing fifty years of existence is indeed a major landmark for any human enterprise, and it inevitably prompts us to reflect on our achievements and shortcomings, above all in the case of the United Nations, which has been the subject of so much controversy, especially in recent times. The analyses of its performance currently being made range all the way from biting criticism to passionate defence, but there tends to be general agreement on at least one thing: the world we live in would be a very different place if the United Nations Charter had not been signed in those far-off days.

The Organization’s defenders point to its concrete achievements in various fields, ranging from peace-keeping operations to vaccination campaigns, and including such varied items as humanitarian assistance, the establishment of common standards for transnational activities, support for elections in infant democracies and, of course, technical cooperation programmes to further development. Its detractors, on the other hand, tend to contrast the Organization’s real achievements during its first fifty years of existence with the possibly Utopian expectations cherished by its founders, or else they concentrate their salvos of criticism on the alleged inefficiency and ineffectiveness of an Organization which they claim is already hidebound and devoid of flexibility. There are also some who have never lost their fear of multi-lateral schemes because of their real or supposed inhibition of national sovereignty, the most radical expression of such fears being represented by those who vociferously reject the “World Government” which they claim the Organization stands for.

Be all that as it may, this is undoubtedly a very suitable occasion not only for taking stock of the Or-

ganization's performance during its half-century of life but also for reflecting on the course it may follow in the next fifty years. Such reflection may be based on the assumption that a constant factor in the institutional activities of the United Nations will continue to be the paramount importance attached to the central objectives of the Organization: "To maintain in-

ternational peace and security", "To develop friendly relations among nations", "to promote social progress and better standards of life", and "to encourage respect for fundamental freedoms for all", since these express universal values that can hardly be opposed, as they never lose their validity and cannot give rise to major disagreement.

II

The discrepancies that exist tend rather to arise in three other major areas. The first of these concerns the adaptation of the Organization's objectives (or ends) to the present-day context; the second refers to the way responsibilities are shared between the Secretariat and member governments, and the third involves the efficiency and effectiveness (the means) displayed in seeking to achieve the proposed goals. I shall now deal briefly with each of these topics in turn.

1. The ends of the United Nations

With regard to the first aspect, there are some who hold that as the risk of a new world war has allegedly disappeared thanks to the end of the "Cold War", the main justification for the United Nations' existence no longer exists. The opposite theory would seem to be much more convincing, however: in a world where virtually all human activities have transnational dimensions, there is an obvious need for a universal organization to aid in the orderly settlement of potential tensions or conflicts of a multinational nature (or, as the case of Bosnia shows, national confrontations with multinational repercussions) and in the organization of joint action to remedy them, preferably within the context of international cooperation. Thus, the United Nations will continue to offer a possibly unique meeting-point where the nations of the globe can consider an ever-wider range of issues, inspired by the basic idea that one country's problems can very well spread to its neighbours, whereas international cooperation will foster the spread of benefits to all.

There are two arguments that support the idea that the purposes of the United Nations have been overtaken by events. One argument holds that the Organization should limit its field of action to peace-

keeping, the defence of human rights, the consolidation of the international rule of law and, perhaps, humanitarian assistance, with all other aspects and issues of cooperation being left to various multilateral agencies, especially those set up as a result of the Bretton Woods Conference. Indeed, a step has already been taken in this direction with the establishment of the World Trade Organization outside the United Nations system. The second argument maintains that most cross-border issues—whether political or economic—are now usually of a regional rather than a global nature, so that—it is suggested—the regional institutions should be strengthened rather than the United Nations (Commission on Global Governance, 1995, pp. 149-153 and 286-291).

The idea of making the United Nations a more specialized body, either in terms of subject-areas (political aspects would be considered acceptable areas of action, but not economic and social issues) or in geographical terms (global aspects would be suitable areas of activity, but not regional ones), is not very convincing either. As the Secretary-General so rightly points out in his proposal entitled *An Agenda for Development*, political and economic phenomena, democracy and security, human rights and material well-being are issues which are now inseparable from one another. His own concept of development therefore comprises five "dimensions": peace, the economy, the environment, social justice and democracy (United Nations, 1994a and 1994b).

If we accept the Secretary-General's proposition that the main causes of conflicts in the world are "economic despair, social injustice and political oppression" (United Nations, 1992, p. 9 and United Nations, 1995), then it is clear that the United Nations cannot renounce its right and duty to intervene in all those dimensions. In the final analysis, it is the only multilateral body capable of integrating transnational

phenomena of a political nature with those of an economic and social character. It is not a question, therefore, of limiting its action to the political field but of selecting the economic and political activities to be tackled selectively and in line with the current priorities. The distribution of tasks among the various multilateral bodies should therefore be viewed in terms of the complementation of each one's activities with those of the others, according to their respective mandates and comparative advantages.

Following the same line of thought, although it is true that regionalism is a powerful force in the world of today, this movement should be complementary to, and not a replacement of, the establishment of orderly global relations and cooperation among nations. Indeed, just as regionalism can be a phenomenon which furthers the attainment of the great objectives laid down in the United Nations Charter, it can also become an adverse force if it fosters the fragmentation of the world instead of its integration. We have devoted a good deal of reflection to this matter in ECLAC in our analyses of economic cooperation in Latin America and the Caribbean, and we have pointed out in this respect that integration agreements can act as either building blocks or stumbling blocks in the quest for better international linkages, depending on the content and scope of the undertakings entered into. Therefore, just as we advocated open regionalism for Latin America and the Caribbean (ECLAC, 1994) in an effort to reconcile regional with international cooperation, it is necessary to avoid any form of cut-and-dried division of such matters between the United Nations and the regional bodies. Once again, this represents a space where the United Nations and the regional bodies should give each other mutual support, as provided for in Chapter VIII of the Charter.

2. Shared responsibility

In its most basic expression, the United Nations Organization is an intergovernmental body which reflects the desire of sovereign States to establish a plurinational instrument for tackling common problems. Governments are usually reluctant to endow such bodies with faculties which detract from national sovereignty. There are instances, however, where certain national spheres of authority have been subordinated to the common interest, as in the case of the European Union, which has entrusted certain

functions to its Commission. In other situations, including that of the United Nations, the tendency is to empower the respective Secretariat to raise initiatives but not to take actual action without the express consent of the member governments. Thus, it might be said, the Secretariats propose but the governments dispose.

It is worth bearing in mind this classical conception of a plurinational body, because it lies at the root of many misunderstandings regarding the Organization's performance. The image of a Secretariat which takes it upon itself to adopt capricious or erroneous decisions or which usurps the functions of national authorities is just as mistaken as the idea that the faults and shortcomings of the Organization are attributable to "irresponsible" attitudes of member governments. This is another way of expressing the obvious truth that the role played by the Organization and the quality of its performance are the responsibility of both parties – governments and Secretariat – and depend on the way they interact with each other.

In other words, both the successes and the failures of the Organization reflect the shared responsibility of the Secretariat and the member governments. The Secretariat cannot be blamed for the unfortunate events in Bosnia, for example, nor on the other hand can it take refuge in the argument that the blame attaches exclusively to governments.

This approach does, however, raise the need to look into the forms of interaction of the Secretariat with its 185 member governments and into the whole question of the effectiveness of intergovernmental forums as places for the taking of decisions. And this question leads in turn to the third item in our reflections: the efficiency and efficacy with which the United Nations carries out its functions.

3. The means

The question of its own restructuring has formed part of the agenda of the United Nations for many years, and in recent years there have been a number of new proposals for adapting it to the demands of the coming century (Ogata and Volcker, 1993; Childers and Urquhart, 1994; Qureshi and von Weizäcker, 1995). In point of fact, many of the criticisms levelled at the Organization concern the cumbersome nature of the decision-making process and the style of work of intergovernmental forums, the alleged inefficiency and ineffectiveness of the Secretariat and

the specialized agencies, and the lack of a sense of direction of the organization as a whole. In other words, it is not so much the *ends* of the Organization that are being criticised as the *means* used to reach them.

It must be admitted that these criticisms are not without a certain amount of justification. For example, it is hard to understand why the composition of the permanent members of the Security Council in 1995 continues to reflect the situation in 1945. It is also undeniable that, after 50 years of institutional life, cases of duplication and overlapping of functions have arisen as the Organization has set up bodies to take care of new issues, without doing away with existing bodies. However, these are aspects which can be put right through the joint action of member governments and the Secretariat itself and which do not affect the essence or principles of the Charter, whose validity remains unquestioned.

There are two main areas in the debate on the best ways to take fuller advantage of the United Nations' enormous potential for encompassing its objectives. The first is connected with the matter already mentioned earlier: how to enhance the synergy of the interaction between the Secretariat and member governments so that each of the parties can do its job in support of the proper functioning of the Organization. The second refers to the quality of the way the Secretariat, the various programmes and the spe-

cialized agencies carry out their activities and the content and scope of the latter.

The adaptation of these two areas to the changing international circumstances is what is usually meant when reference is made to the "reform" or, in even more euphemistic terms, the "revitalization and restructuring" of the United Nations. Many skeptics doubt whether it is really possible to make any progress in these changes in view of the presumed lack of "political will" on the part of most governments, the resistance to change attributed to the international bureaucracy, and, above all, the enormous magnitude and complexity of the task. However, the changes already put into effect in the last two years (United Nations, 1994c) and the number of proposals under consideration (both for increasing the efficiency and efficacy of the Secretariat and for streamlining the functioning of intergovernmental forums) suggest that these gloomy forecasts may be somewhat premature. There are signs that the necessary adaptation will indeed take place in a deliberate and well-conceived manner, thanks to the joint efforts of member governments and the Secretariat. Even if this were not so, it is in any case highly likely that the Organization will be impelled by the force of circumstances to adapt to a world that is qualitatively different from that which determined its activities during its first fifty years of life (Communiqué of the Group of Seven, Halifax, Canada, paragraph 36).

III

Against the background of all this discussion about what the United Nations has achieved in its first fifty years: what is to be said about the work of ECLAC? And even more importantly, are there any lessons that the Commission can contribute in order to consolidate the achievements and correct the shortcomings that the Organization as a whole has displayed? When we make such an appraisal, it would appear that this microcosm within the United Nations system, whose action is limited to the economic and social spheres, warrants a rating above the average, at least if its performance is subjected to the most stringent of all tests: that of its relevance and pertinence. Especially in its pioneering years, ECLAC had an undeniable impact on the concept and praxis of public policy in Latin America and the Caribbean, and this

influence is all the more noteworthy because it came from our analytical work: that is to say, from the abstract world of ideas.

It is worth looking at the specific components which have made possible the Commission's relative success in the course of its life as an institution. In this respect, there are five elements that should be highlighted: first, we identified a function through which we could be of benefit to our member governments; second, we managed to shape an "institutional message" and a personality of our own; third, we managed to maintain our validity over the years by adapting to the changes taking place in our institutional context; fourth, we were successful in establishing a lively and creative form of interaction with member governments; and lastly, there was constant

concern to keep up high standards of quality and performance.

1. ECLAC's function

When the Commission was set up in 1947, the relevant Economic and Social Council resolution assigned it one very general function and two more specific ones. The general function was: "raising the level of economic activity in Latin America and ... maintaining and strengthening the economic relations of the Latin American countries both among themselves and with other countries of the world". The more specific ones were to "Make or sponsor such investigations and studies ... as the Commission deems appropriate" and to "Undertake ... the collection, evaluation and dissemination of ... economic, technological and statistical information...".¹ Member governments and the Secretariat were faced with the task of giving real content to a mandate which was actually extremely broad.

The successful implementation of that mandate turned ECLAC into a recognized centre of Latin American economic thinking and a highly respected source of information. ECLAC supplemented this work with some activities designed to promote cooperation and others of an operational nature, especially in the fields of training and technical assistance. In this way, the Commission undoubtedly fulfilled the mandates assigned by the United Nations in the economic and social sectors (the Charter specifically refers to the function of promoting the economic and social progress of all nations), while at the same time it filled a vacuum at the regional level, since at the beginning of the 1950s there was no other public or private institution devoted to analysing economic development from the standpoint of the countries of the region.

In carrying out its tasks, the ECLAC Secretariat developed a style of work with some distinctive features, especially the fact that in its analytical activities it always gave priority to the links between theory and praxis. In other words, research was cen-

tered on questions of real or potential interest for policy-makers. This criterion of placing concepts at the service of action, or ideas at the service of reality, also explains the inductive nature of the Secretariat's work, which means that its economic policy recommendations are backed up by conceptual interpretations which are validated in turn by concrete situations.

Furthermore, a regular feature of ECLAC's manner of working was its questioning of the mechanical application of conventional thinking to Latin American conditions, which also meant questioning the assumption that the effects produced by economic policy measures were bound to be similar in each case, regardless of whether they were applied in developed or developing economies.

In its pioneering years, ECLAC carried out this function in a creative and original manner. In-depth country studies were made: something virtually unknown at that time. The international situation was analysed in terms of its incidence on the region's economies. A system was organized for the preparation of indicators and statistical information in all the countries, using common methodologies, so as to be able to evaluate economic and social performance throughout the region. Initiatives were set afoot for promoting intra-regional cooperation, especially in Central America. Perhaps the most ambitious undertaking, however, was the effort to put together a holistic proposal incorporating a coherent set of ideas on the economic progress of Latin America in the decades following the war, starting from an element common to all the countries: the way they interacted with the world economy.²

In short, the institution (the Secretariat and its member countries) constructed a working space or functional niche which provided it with its *raison d'être* in the eyes of its member governments and within the United Nations. Indeed, the Commission succeeded in embodying the objectives and global principles of the United Nations Charter in a tangible presence in the region, with proposals that could be translated into concrete actions. In this respect, with-

¹ Economic and Social Council resolution 106(VI), 25 February 1948. In subsequent resolutions, these functions of the Commission were expanded by the addition of others, such as cooperating in the formulation and development of coordinated guidelines to serve as the basis for practical action to promote the economic development of the region, helping to carry out functions connected with the United Nations technical assistance programme, and dealing with the social aspects of development.

² The best-known document in this respect, which Albert Hirschman baptised the "ECLAC Manifesto", was ECLAC, *Economic Survey of Latin America, 1949*, United Nations, New York, 1951 (United Nations publication, Sales No. 1951.II.G.1).

out in any way seeking to preach given doctrines, the Secretariat placed itself at the service of governments as a kind of sounding-board for ideas and recommendations likely to foster debate and as a means of backing up the exercise of collective reflection with research, advisory assistance, training, and the formulation of interpretations and proposals with respect to economic policy.

2. ECLAC's identity

The fulfillment of this function has also been accompanied by the development of a certain institutional "seal of identity", based on the set of ideas which has inspired the Secretariat's work from the beginning, but can in no way be seen as an ideology. This set of ideas stemmed from the dual commitment which the founders of the institution imparted to all its activities: on the one hand, a commitment to development (and hence also to change), and on the other, a commitment to ECLAC's deep-seated Latin American identity (and also Caribbean, from the 1970s onward). Thus, historically the Commission has tackled the development agenda from the standpoint of the countries within its geographical radius of action.

This is not the place to refer to the basic concepts and proposals of the Secretariat, which are in any case very well known. What is worth stressing, however, is the capacity displayed by ECLAC for putting together a form of economic thinking of its own, and especially for enhancing the economic theories currently in vogue in the world and adapting them to the actual conditions of the Latin American countries. This quality also explains ECLAC's outstanding capacity for generating interest and support, especially in its pioneering years. Indeed, ECLAC's economic thinking has become part of the intellectual heritage of Latin America: a store of knowledge which is appreciated as something precious, even by those who deeply disagree with the original theories of the Commission. This institutional identity is relatively rare in the United Nations system, and it represents an asset of the highest importance.

3. Adaptation to new circumstances

Another central feature of the Commission has been its capacity to adapt itself constantly to new circumstances, especially as regards the content of its "message", but also in terms of its organization.

With regard to the first of these aspects, in view of the fact that actual conditions are subject to constant changes, ECLAC recognized from the very beginning that it was essential to mould its thinking to the changing economic and social circumstances, including the changes due to development policies themselves. The Secretariat therefore never saw its conceptual matrix as an immutable body of ideas, and Raúl Prebisch himself repeatedly stressed the need for the unceasing renewal of ECLAC's thinking (Prebisch, 1978).

Thus, the Commission was well placed to interpret the circumstances and conditions of the region when it began to emerge from the sequels of the 1930s and the vagaries of the Second World War, proposing among other things the promotion of industrialization and selective public sector intervention in the economy: guidelines which appeared eminently reasonable as means of tackling the obstacles hindering development at that time. Later, in the 1960s, the institution laid increasing stress on the need to diversify and modernize the region's export capacity in view of the long-standing current account deficits of the vast majority of the countries (ECLAC, 1961).

Basically, as changes took place both in the outside environment and within the region itself, ECLAC strove to update its proposals. This ongoing task, seen as a never-ending process or duty, reached record levels in recent years because of the surprising changes undergone by the region and its international environment in the 1990s. The results of this effort were compiled in a set of publications from 1985 onwards (ECLAC, 1985 and 1987), and these questions were dealt with in particular depth as from 1990, with the document *Changing production patterns with social equity* (ECLAC, 1990). Subsequent studies took up more specific issues and that global frame of reference continued to be developed and analysed in greater detail (ECLAC, 1991, 1992, 1994 and 1995; ECLAC/CELADE, 1993; ECLAC/OREALC, 1992).

The fact that ECLAC takes such pains to adapt its proposals to the changing circumstances and concerns of the region is a logical consequence of its fulfillment of the mandates for which it was originally established. A conscious effort is made to ensure that the analytical work is pertinent and useful, so that it has to be centered on the issues which occupy the attention of the policy-makers of member govern-

ments. This does not mean, of course, that the degree of relevance of the Commission's proposals has remained unchanged throughout the life of the institution: the early work of the Secretariat not only reflected its most creative period but also the period when it had most influence on economic policy application.

In this respect, both the content of the message and member governments' receptiveness to it have tended to vary over time. Even as far back as the 1960s, some authors perceived a "loss of intellectual leadership" (Fishlow, 1985). Rather than representing a sign of decadence, however, this observation indicated that governments had a growing capacity of their own in terms of the formulation and application of economic policies and strategies, while at the same time there was an ever-wider range of opinions offered by international, and in some cases local, centres of economic thinking.

If ECLAC's work is seen as the provision of a sounding-board for ideas and recommendations that can give rise to fruitful debate, then the fact that the institution was losing its "monopoly" over regional economic thinking should actually be interpreted as a highly positive development, since this meant that its activities were finding an ever-stronger echo at the country level. For the Commission, the increase in the number of its interlocutors and the change in its style of interaction with them (an aspect which will be dealt with later in this article), together with its capacity to identify and analyse the key issues of the moment, have been the main factors which have allowed it to maintain its validity without interruption.

In its institutional structure, too, ECLAC has shown its ability to adapt itself to new circumstances. In particular, it has been capable of incorporating new items into its work programme without, in most cases, setting up new units to deal with them. This has been possible because the prime focus of the institution is the development of the Latin American and Caribbean countries, and the issues which have been emerging in the course of time—the energy crisis, human settlements, the external debt crisis, short-term economic policy, the environmental dimension, equality of the sexes, the role of transnational corporations—have been incorporated into the central work of the Commission using a multidisciplinary approach, rather than tackling them in isolation. In this way, it has been possible to avoid conflicts due to the superimposition of new questions

on top of long-standing issues and the creation of new units on top of existing ones.

Likewise, ECLAC has managed to preserve its very special role within the overall range of Latin American and Caribbean pluri-national institutions. The constant concern to avoid duplication of activities between the United Nations (in the economic and social spheres) and the Bretton Woods institutions is not a problem at the regional level. On the one hand, the latter institutions do not have bodies operating at the strictly regional level, and on the other, ECLAC's activities have remained sufficiently different from those of the IDB, the OAS and SELA to avoid any risk of duplication. Indeed, the opposite is the case, since deliberate efforts have been made to secure greater complementation between the activities of ECLAC and those of the regional bodies in question, sometimes through formal cooperation agreements.³

4. The links between governments and the Secretariat

It is easy sometimes to lose sight of the fact that ECLAC represents the sum of its member governments "institutionalized in intergovernmental forums" and the Secretariat. The way these two groups interact goes a long way towards determining the degree of relevance of the institution as a whole.

Here, the links between the two groups go beyond those normally envisaged when thinking of the traditional image of intergovernmental bodies ("the Secretariats propose and the governments dispose"): instead, a dynamic and creative working relationship has been forged between the two. Within this framework, the comparative advantages of the Secretariat are the following: first, its capacity for reflection on medium- and long-term options and strategies, and second, the multi-faceted image it has earned by the fact of carrying on activities in all the countries. For their part, the governments have the advantage of possessing an intimate knowledge of their own national situations, especially as regards the constraints perceived in difficult short-term circumstances.

³ Thus, a Special Cooperation Committee has been operating between the OAS, the IDB and ECLAC for many years. Recently, this Committee has been given specific mandates as a result of the Americas Summit held in Miami in December 1994. See, for example, the Joint Declaration issued by the Ministerial Meeting on Trade on 30 June 1995.

Bringing these two viewpoints together greatly enhances the institution's capacity for creative work and action at the regional level.

The interaction between governments and the Secretariat is an ongoing practice and takes many forms, including country visits by ECLAC staff members, visits by government authorities to the Commission, meetings, seminars, and all kinds of other contacts. There is also a broad range of national-level actors who form part of the system of consultation between the Secretariat and governments. Outstanding among them are the economic ministries (which are the main interlocutors of ECLAC) and the ministries of foreign affairs, which are responsible for formal contacts with the United Nations. In this respect, the ECLAC Secretariat has managed to build bridges among the various areas of jurisdiction which exist within governments—and which are reflected in the United Nations Secretariat too—and this has greatly enriched its own work. Finally, this interaction is not limited to governments, since it also extends to the academic community and private agents of the region.

5. Standards of performance

The concept of "centre of excellence" is a subjective idea which admits of various different interpretations. If we use the conventional parameters applic-

able to an intergovernmental body, however, it would certainly be no exaggeration to apply this term to the ECLAC Secretariat. This is attested by the quality and professionalism of its principal documents, the calibre and prestige of the staff members who have served in the Secretariat during its 46 years of existence, its capacity to mobilize interest and support, and the trustworthiness of the information it provides.

Likewise, the application of conventional criteria of productivity suggest that the efficiency and efficacy of ECLAC are well above the average for the United Nations. Rigorous standards are maintained as regards the programming of activities, quality control, performance evaluation, the impact of ECLAC's action with respect to its main clients (member governments) and intra-institutional development.

This does not mean, of course, that there is no room for improvement in ECLAC's performance. However, bearing in mind that many governments—especially of developed countries—currently display a tendency to question the achievements and doubt the usefulness of the international agencies, it is worthy of note that—at least in the case of the Latin American and Caribbean countries—the public and private actors with which the Commission has to do apparently continue to regard it with a high level of approval.

IV

This article does not seek to present ECLAC as a model that should be imitated by the rest of the United Nations. That would not only be presumptuous but would also ignore the fact that many of the factors conditioning the institutional life of the Commission—especially its historical background—are not applicable in other contexts. Nevertheless, some of the strengths of the institution are indeed the result of factors that could offer some pointers for the reform of the United Nations as a whole. Among these elements, as I already noted, is the fact that ECLAC occupies a well-defined functional ambit, has succeeded in building up an institutional personality or identity of its own, has developed a great capacity to adapt to changing conditions, has fostered a dynamic and creative form of interaction between the Secretariat and its member governments, and has maintained rigorously high standards of management and

performance. This list is a good definition of the kinds of reforms that are needed for the United Nations system and, within it, ECLAC itself.

To sum up, then, when drawing up a balance-sheet of the work of the Organization on the occasion of its fiftieth anniversary, we should not limit ourselves only to paying tribute. It is also important to identify its flaws and shortcomings, with a view to making the changes needed to allow it to face the challenges of the next fifty years. It would appear that the will exists—both among governments and within the Secretariat—to make these changes a reality. There is therefore every reason to face the future with serene optimism and faith that, as the next century draws near, the Organization will keep on fulfilling the purposes for which it was created.

(Original: Spanish)

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The creation *of the United Nations* and ECLAC

Hernán Santa Cruz

I

The birth and first infant steps of the United Nations Organization

When the countries which fought in the 1914-1918 war –considered at that time to be the most brutal conflict in human history– signed the Versailles peace accords, it was said that nothing like it could ever happen again. Seventeen years later, however, a second world war broke out which was truly universal and ten times bloodier than its predecessor.

What had gone wrong to allow this to happen? Winston Churchill, who took part in both conflicts and was one of the architects of the Allied victory, said very rightly that the Second World War took place because of the lunacy of the victors of the First World War.¹

□ As part of the aim of reviewing the main changes which have taken place since the establishment of the United Nations, and especially of ECLAC, the distinguished Chilean diplomat Hernán Santa Cruz, who personally participated in the creation of these institutions, was invited to contribute this retrospective analysis.

¹ In reality, the Second World War consisted of three conflicts which later merged into a single one: the war by Japan against China, which began in 1931 with the surprise invasion of Manchuria, subsequently spreading to the whole of Southeast Asia and Oceania and culminating with Japan's attack on the United

In the face of this apocalyptic situation, the leaders of the Western democracies –one of which, France, had already been temporarily defeated– began as from 1941 to mobilize the nations which were opposed to the Nazi and Japanese aggression with a view to making plans and adopting measures to establish an international order, once the war was over, that would ensure that all the peoples of the earth could live in dignity and prosperity.

In January of that year, in an address to Congress, the President of the United States, Franklin Delano Roosevelt, set forth the doctrine of the "Four Freedoms" for which the world should strive: "freedom of speech and expression, ... freedom of every

States, at Pearl Harbor; the ruthless conquest of Ethiopia by Mussolini; and the crazy actions of Adolf Hitler, who invaded Poland after having annexed Austria and Czechoslovakia before the indifferent gaze of the rest of the world, proceeded to attack Norway, Belgium, Luxembourg, Holland, the Balkans, Finland and the Soviet Union –thus obliging France and the United Kingdom to take up arms in defence of their countries– and allied himself with Bulgaria, Romania and Hungary. The three wars thus merged into one, with slight variations in the participants. When the Axis of Germany, Italy and Japan was formed, the last-named country launched an underhand attack on the United States fleet at Pearl Harbor.

person to worship God in his own way, ... freedom from want, ... and freedom from fear ... –everywhere in the world”. In August of the same year, President Roosevelt and the Prime Minister of the United Kingdom, Winston Churchill, formulated a joint declaration known as the Atlantic Charter, which laid down a number of principles and policies to be put into effect when peace was achieved, so that the peoples of the world could live “free from fear and want”. These concepts included –in their broad lines– those that were to be incorporated four years later in the Charter of the United Nations. Five months later, 26 nations –including eight from Central America and the Caribbean– signed a declaration which was to have momentous consequences: the Declaration of the United Nations (thus named at the suggestion of President Roosevelt). This Declaration endorsed the contents of the Atlantic Charter and affirmed the signatories’ opposition to the aggression of the Axis. In the course of the period from 10 January 1942, when the Declaration was signed, and the San Francisco Conference, a further 26 States adhered to it, including all the South American countries except Argentina.² Chile signed in February 1945.

In October 1943, at Moscow, the Ministers of Foreign Affairs of the United States, the United Kingdom and the Soviet Union took a more concrete step towards the establishment of a world-wide system of security and cooperation when they adopted the General Security Declaration, whereby they undertook to continue their joint action to organize and maintain peace.

The next step was the Dumbarton Oaks talks, held near Washington, D. C., in which the participants were the United States, the United Kingdom, the Soviet Union and China. The first two countries had prepared detailed proposals for “the establishment of a General International Organization”. These proposals were sent to all the countries which had signed the Declaration of the United Nations and were also sent to the conference on the problems of war and peace held at Chapultepec, Mexico, with the participation of the member nations of the Pan-American Union. This conference was called the Inter-American Conference on War and Peace, and was held from 21 February to 8 March 1945, a few weeks before the San Francisco Conference.

² Argentina adhered to the group in the first few days of the Conference.

Problems had already arisen in the preparation of the agenda for the Chapultepec Conference. The United States was extremely interested in reaching agreement with its neighbours on their more active cooperation to end the war. It did not want the Dumbarton Oaks proposals to be debated in depth, because the Yalta Conference between Roosevelt, Churchill and Stalin had just ended, and the agreements on the veto and other matters concerning the future world organization were kept secret because they might upset the United States’ neighbours to the south. The United States was also against the entry of Argentina into the United Nations because it considered it to be a “fascist nation”. The Latin American countries favoured its admission, however, on the grounds of universality and because they felt that the reasons put forward by the United States represented interference in Argentina’s internal affairs.

During the Conference, the Latin American representatives set forth in writing the main aspects of their concept of international relations.

Furthermore, in the Final Act they included resolution XXX, in which they expressly set forth the general points of view which they wanted to be taken into account at San Francisco and which differed in many respects from the Dumbarton Oaks proposals or proposed new provisions.³

In resolution XXX the Latin American nations declared that the Dumbarton Oaks proposals constituted a basis and a valuable contribution for the establishment of the General Organization, but they asked that the World Conference should take account of their views. In other agreements, the Conference reaffirmed the principles of the Atlantic Charter and stressed the importance of freedom to transmit and receive information and of the cooperation of women in international meetings.

³ The main points in this respect were: a) the desire for universality; b) the need to expand and specify the list of the purposes and principles of the Organization; c) the need to expand and specify the faculties of the General Assembly and harmonize them with the faculties of the Security Council; d) the need to expand the jurisdiction and competence of the International Court of Justice; e) the need to set up an international body specially entrusted with the task of promoting intellectual and moral cooperation among nations; f) the need to settle controversies and issues of an inter-American nature, in line with those of the Organization; and g) the need that Latin America should be adequately represented on the Security Council.

There still remained an episode of capital importance in the preparations for the great event which was to discuss the creation of the United Nations system, however: the Yalta Conference. The most important agreements reached by the Great Powers at this Conference concerned the creation of the United Nations. It was decided to call a "Conference on World Organization", to be held in the United States beginning on 24 April 1945.⁴

1. The San Francisco Conference adopts the United Nations Charter and sets up the World Organization.

On 25 April 1945 the Conference on World Organization, convened by the four great powers, began its work in the city of San Francisco. It was at that time, and still is, the most important congress in history. It gave rise to the United Nations Charter, an international treaty of unprecedented scope and significance, to which 184 nations are now parties.

The nations invited to this great event comprised only the 46 countries which had signed the Declaration of the United Nations or adhered to it.⁵

The San Francisco Conference was therefore not an expression of total universality. The losers in the war were not represented at it, and these countries included not only Germany, Italy and Japan but also Bulgaria, Romania, Hungary and Albania, while Spain was also placed in this category as it was accused by the United Nations of having favoured the Axis countries.⁶

Furthermore, Franklin Delano Roosevelt, who was anxiously awaited by all as the father of the Allied victory and the main architect of the proposed international order for the post-war period, had died thirteen days earlier from a heart attack when he was preparing to travel to San Francisco. The Conference

was therefore opened by the new President of the United States, Harry Truman, who had little experience in international affairs and whom Roosevelt had not had time to initiate in the details of the complex negotiations on the future peace. Nor had he been informed about the construction of the atomic bomb, which was on the point of completion. Nevertheless, this novice Head of State of the mightiest nation in the world behaved from the very first day with dignity, courage and decision in the actions which led to the end of the war with the surrender of Japan.

Paradoxically, it fell to his lot to bring about that surrender by ordering the nuclear bomb attacks which devastated Hiroshima and Nagasaki.

The foregoing factors meant that the delegations were made up of the best statesmen that the participating governments had at their disposal in the political and diplomatic fields. Among them were notable personalities who had distinguished themselves during the war and the years before it: Molotov and Eden, the Ministers of Foreign Affairs of Stalin and Churchill, respectively; Paul-Henri Spaak, the Prime Minister of Belgium; Jan Masaryk, the Chancellor of Czechoslovakia; Georges Bidault and Alexandre Parodi, two leaders of the French Resistance; Roberto Urdaneta and Alberto Lleras Camargo, both ex-Presidents of Colombia (the latter was President on two occasions and played an outstanding role at San Francisco); Camilo Ponce, who was to be President of Ecuador in the 1950s; Dimitri Manuilski of the Ukraine, a veteran of the October Revolution and a former head of the Comintern; Sir Ramaswami Mudaliar from India, a member of Churchill's War Cabinet and brilliant Chairman of the Committee responsible for economic and social matters at the Conference; Edward Stettinius, Roosevelt's last Secretary of State, and Cordell Hull, who had also occupied that post for a long time during the Roosevelt administration; Senators Vandenberg and Connally, respectively leaders of the minority and the majority in the

⁴ Agreement was also reached on the voting mechanism to be used in the Security Council: namely, that substantive decisions of the Council must be approved by five of the eleven permanent members: the United States, the Soviet Union, the United Kingdom, China and France. It was also decided to uphold at the World Conference the right of the Soviet Republics of the Ukraine and Byelorussia to be admitted as members of the United Nations.

⁵ The Conference itself decided to admit four more countries: Argentina, Byelorussia and the Ukraine, as a result of the Yalta agreements, and Denmark, after its liberation from Nazi occupation. Thus, a total of 50 States participated in the San Francisco Conference.

⁶ Most of the Third World nations were not represented either. Thus, in the case of Africa, which now has a large number of sovereign nations, the only participants were Egypt, Ethiopia, Liberia and South Africa, and the last-named country could hardly be considered as a member of the Third World at that time. Asia and the Far East were represented only by India (which had not at that time been granted independence and included the present nations of Pakistan and Bangladesh), China and the Philippines. Proportionately, the Middle East was better off, as it was represented by Iran, Iraq, the Lebanon, Saudi Arabia and Syria.

United States Senate and architects of that country's two-party international policy; Sir Alexander Cadogan, Churchill's Under-Secretary of Foreign Affairs and a participant in all the preparatory meetings, including Yalta; and a host of other illustrious personalities.

Latin America attached such importance to this Conference that of its 20 delegations 17 were headed by Ministers of Foreign Affairs. The delegation of my own country included, in addition to the Minister of Foreign Affairs, a number of notable politicians and parliamentarians, among them Gabriel González Videla, who was elected President of the Republic a few months later.⁷

The general climate prevailing at the meetings was exceptionally constructive, bearing in mind the final results. Although the Dumbarton Oaks proposals, which formed the basic documents for the Yalta discussions and political agreements, were respected, the Conference amended some of the proposals of its four sponsors.

On the initiative of the developing countries—Latin American for the most part—the Charter expanded and extended the objectives of the United Nations in the economic, social and human rights spheres.

Thus, for example, the Dumbarton Oaks proposals did not include among the "Purposes and Principles of the United Nations" the present paragraph 3 of article 1 of the Charter, which says:

"To achieve international co-operation in solving international problems of an economic, social, cultural, or humanitarian character, and in promoting and encouraging respect for human rights and for fundamental freedoms for all without distinction as to race, sex, language, or religion."

With regard to economic and social cooperation, the Charter also included among its objectives "the creation of conditions of stability and well-being which are necessary for peaceful and friendly relations among nations" and the promotion of "higher standards of living, full employment, and conditions of economic and social progress and development".

⁷ The members of the delegation were Joaquín Fernández, Marcial Mora, Miguel Cruchaga, José Maza, Gabriel González Videla, Carlos Contreras Labarca, Eduardo Cruz-Coke, Félix Nieto del Río, Amílcar Chiellini, Enrique Alcalde, Guillermo del Pedregal, Oscar Gailardo Villarroel, Germán Vergara Donoso and Julio Escudero.

The exceptional importance which the Charter attaches to these responsibilities is further accentuated through the institutional change which it introduced. It gave the Economic and Social Council the rank of a main organ of the United Nations—whereas the Dumbarton Oaks proposals only gave it the status of a subsidiary body of the General Assembly—and entrusted it with "Responsibility for the discharge of the functions of the Organization" in the areas in question, under the authority of the General Assembly.

The United Nations Charter was unanimously approved by the participants in the Conference on 26 June 1945, and it came into force on 24 October of the same year, after ratification by the member States.

The Latin American nations maintained progressive positions and did not seek advantages that would serve the special interests of any particular State. In the beginning, they did not seem to be very keenly aware of the geopolitical realities existing at the end of the war, when the United States, the Soviet Union and the United Kingdom were already far from coinciding in their interests and were united only by the desire to keep the peace. The Latin American countries, for their part, desired a world order in which there would be strong cooperation in the political and economic fields, within a context of the strictest respect for the principles of equality, non-intervention, freedom of decisions, solidarity and fraternity and other principles which they considered to have been incorporated in international law, which they had helped to improve and sought to strengthen. Thus, when discussing the question of non-intervention in the internal affairs of other States, the Chilean representative, Gabriel González Videla, said that "since the appearance of the Nazi and fascist systems, it had become necessary to reduce what had traditionally been called the domestic jurisdiction of States, and there were now problems of an internal nature which should be investigated by the World Organization, such as violations of the fundamental freedoms of mankind which tend to endanger the peace of nations".

The majority of the delegations therefore agreed that it was preferable to seek the best Charter that could be achieved under the prevailing circumstances without running the risk of causing the breakdown of the system it was desired to create. Consequently, the system of the veto in the Security Council was ac-

cepted on the terms agreed at Yalta. The efforts to secure acceptance of the principle that the veto should not be operative in decisions on the peaceful settlement of disputes, in amendments to the Charter, and in the struggle for the effective application of the concept of the self-determination of peoples, by creating mechanisms which really did ensure the independence of former colonies, were defeated. In this respect, the agreement among the big powers demanded by Churchill, to which reference has already been made, proved to be too strong to be overcome. Nor were the Latin American countries successful in their proposals for an explicit definition of the term "aggression" and acceptance of the obligatory jurisdiction of the International Court of Justice.

Nevertheless, the Latin American countries did secure some important triumphs. Perhaps the most important of these were the substantial changes made, with the active collaboration of other countries, in order to significantly transform the United Nations' role in economic, social and humanitarian cooperation. It is thanks to this that matters of human rights and economic and social development have become priority activities of the organizations in the system.

The fervent desire of the Latin American countries to perfect the Charter in its moral and juridical aspects was only partly fulfilled. Nevertheless, at San Francisco the Latin American nations represented in a worthy and admirable manner the interests of a Third World which was almost entirely absent from the deliberations but later on espoused the causes promoted there.

I believe that the United Nations Charter must be seen as a truly transcendental instrument which contains the most fundamental guidelines that needed to be applied in the new world that was arising after the war in order to do away for ever with the horrifying brutality that cost the lives of vast numbers of human beings.

2. The United Nations Charter

The United Nations Charter was set forth at the San Francisco Conference on 21 June 1945, at the end of that meeting, and its Preamble reads as follows:

*We the peoples of the United Nations,
determined*

"to save succeeding generations from the scourge of war, which twice in our lifetime has

brought untold sorrow to mankind, and to reaffirm faith in fundamental human rights, in the dignity and worth of the human person, in the equal rights of men and women and of nations large and small, and

"to establish conditions under which justice and respect for the obligations arising from treaties and other sources of international law can be maintained, and

"to promote social progress and better standards of life in larger freedom ...".

The novel element which gives the United Nations Charter its historical value and present validity is that it conceives a world order and makes human beings the centre of its interest and action, in their capacity as individuals, citizens, and members of a race governed by principles of equality, justice and solidarity.

According to the United Nations Charter, international economic and social cooperation is one of the central elements of the World Organization's system. This is clear from the contents of the Preamble, the Purposes and Principles set forth in article 1, and the whole of chapter IX, especially articles 55 and 56.

The United Nations Charter not only extended the concept of security to the prevention of conflicts but also considered it indispensable for the system to promote the creation of favourable conditions for peace which were not limited to those of a political nature.

These texts were drafted in the name of the peoples of the world because they undoubtedly did represent the will of a world which was awakening from a horrible nightmare that had lasted 20 years and did not want to see this repeated in its own lifetime or that of future generations.

The truth of this assertion that the Charter is still fully valid is proved by the fact that the appeals by millions of human beings and hundreds of institutions in the world for an end to the oppression of peoples and individuals are based on the provisions of this instrument and its legitimate offspring: the Universal Declaration of Human Rights, the agreements signed by governments to respect its terms, and the various conventions adopted by the General Assembly in this field. Likewise, for the past fifty years the proposals put forward by the developing countries, who represent two-thirds of all mankind, have been based on articles 1, 55, 56 and 60 of the Charter.

No-one could claim that these mandates have been completely fulfilled, but fortunately the Copenhagen Social Summit has opened up magnificent avenues for us to ensure that all those efforts made over the last 50 years are indeed respected.

It is interesting to note that the provisions of the Charter on international economic and social cooperation (chapter IX) did much to spell out and reflect the right of under-privileged peoples –two-thirds of all the world's inhabitants– to enjoy a decent life, although this did not form part of the draft Charter approved at Dumbarton Oaks in October 1944 by the United States, the United Kingdom, the Soviet Union and France.

3. The Preparatory Commission

The last decision taken by the San Francisco Conference was to designate a Preparatory Commission for the United Nations Organization, in order to make the necessary provisional arrangements. The Commission worked from 27 June to 26 December 1945, and did an excellent job.

Among its tasks was that of deciding where United Nations Headquarters should be located. Lengthy discussions were needed in order to settle this matter. The curious thing is that the Soviet Union fought to have the Organization installed in the United States, whereas other countries wanted it to be located in some European nation. The matter was settled when John D. Rockefeller offered US\$ 8.5 million in order to buy a site in New York and build the handsome edifice which has housed United Nations Headquarters since 1952.

The Organization began its activities in February 1946. The General Assembly –the main organ of the United Nations– was set up immediately, and held its first session that same year in two periods: January and December. The Economic and Social Council was set up in the latter month and carried out very important work at the two meetings it held in 1946.

4. My entry into the activities of the United Nations

i) The stage and its setting. My first encounter with the United Nations was in early February 1947. The Organization was operating at a place called Lake Success, over 20 miles from New York, while the construction of the great building that was to

house United Nations Headquarters was awaited. The office of the Chilean delegation was on the 62nd floor of the Empire State Building in New York, which was at that time the tallest building in the world, however. The place where the Organization began its work was a big square single-storey industrial building which had been constructed during the war as an arms factory. However, Lake Success was surrounded by beautiful countryside with a number of sumptuous mansions of pre-war millionaires. The General Assembly, for its part, met in a pretty pavilion at Flushing Meadows.

I took up my duties a few days after arriving in New York and was received by the Secretary-General of the Organization, Trygve Lie, a Socialist who had been Minister of Foreign Affairs of Norway and had led his country's delegation to the San Francisco Conference. I was to work with him right up to the end of his term as Secretary-General, which coincided with my term as Ambassador.

ii) The actors. At that time the Organization had six Departments, all under the direction of excellent officials. Among them, I should like to make special mention of the Chilean Benjamín Cohen, who had been appointed as Assistant Secretary-General for Public Information. He was a many-sided personality with extraordinary political skills and also an excellent journalist who served for a number of years in that post and left behind him the most agreeable memories. Another official whom I cannot fail to mention was Henri Laugier, the Assistant Secretary-General for Social Affairs, who was one of the most intelligent, imaginative and essentially human men I have ever known. He was a Doctor of Medicine and Professor of Physiology at the Sorbonne, and had been appointed as the first Rector of the University of Algiers during the war. He also led the French delegation to the Conference that set up UNESCO.

Another unforgettable personality was Ralph Bunche, a coloured United States citizen who was one of the most brilliant officials of the United Nations and was finally awarded the Nobel Peace Prize in 1950 for his magnificent work for the Organization: the first time that honour had been given to a coloured man.

iii) The United Nations and the public. It is interesting to note that nothing better exemplifies the great hopes aroused by the United Nations all over the world than the attitude taken to it by the American man in the street and the Press, especially in New

York. The leading newspapers and news agencies kept some of their top correspondents at Lake Success and Flushing Meadows, where the General Assembly was meeting. All the newspapers reported on the most important matters discussed by the Organization, and the two most influential newspapers in New York and perhaps in the whole country—the *New York Times* and the *New York Herald Tribune*—devoted at least half a page to the United Nations and printed the main events of the previous day and the agenda for the current day in a highlighted box. The news agencies, for their part, sent off the full text of the most important speeches or of those dealing with particular countries or regions.

The year I became part of the United Nations' activities was an outstanding year in its existence. The truth is that its great efforts to guide joint action by Eastern and Western Europe to rehabilitate the shattered and overturned continent were only initially successful. The outbreak of the Cold War prevented that objective from being achieved in full. Nevertheless, it was possible to vigorously embark on activities which have been and continue to be among the central concerns of the great majority of mankind. Those early years of the World Organization also witnessed the beginning of the Third World's struggle to secure the fulfilment of the commitments contained in the Charter on economic and social development and the definition of the human rights which the Charter ordered to be respected and protected.

5. The Economic and Social Council in 1947: its value and importance

When the fourth session of the Economic and Social Council opened, I had the privilege of attending it as my country's representative, thanks to the intervention of the Chilean delegates Germán Vergara and Manuel Bianchi, who had succeeded the previous year in obtaining Chile's inclusion in the Council.

I think it would be of interest to recall what the United Nations Economic and Social Council was in that year, what it represented, and how it was made up. At that time—just as it is today—it was the main world institution responsible for guiding international cooperation to solve the great problems of the new era of peace and create suitable conditions to ensure that it lasted, as conceived by the delegates at San Francisco. Its agenda included the most burning questions of the moment, and the interest of most

governments in giving prestige to its work and real weight to its resolutions was reflected in the high quality of the delegates.

Among the members of the Council, I should like to recall in particular Willard Thorpe, Assistant Secretary of State for Economic and Social Affairs of the United States, who was one of the most capable, well-rounded, balanced and technically skilled United States delegates I have ever known. There was also Pierre Mendès-France, a highly respected politician of the post-war era, who headed the French delegation. He was Minister of the Economy in De Gaulle's first government. His performance as Prime Minister in 1954 was extraordinarily effective, especially because he became the driving force for peace in Indochina and took the decision to grant Tunisia its independence. He was the first European statesman to understand the importance of promoting the economic and social development of the developing countries.

The head of the United Kingdom delegation was Hector McNeil, Minister of State for Foreign Relations, an outstanding debater who died while still a young man.

I must also mention Professor P. C. Chiang, one of the most picturesque delegates, with the most striking personality, who have ever passed through the United Nations. He was a Professor in the University of Chicago and had represented his country in Chile.

Other notable personalities were Charles Malik of the Lebanon, who became President of the United Nations General Assembly, Paul Martin of Canada, who became Prime Minister of his country, and Walter Nash of New Zealand, who had been a member of Churchill's War Cabinet and who later became Prime Minister of New Zealand.

The Latin American members of the Council, in addition to Chile, were Cuba, Peru and Venezuela. The Cuban delegate, Guillermo Belt, who was an excellent lawyer and diplomat, also headed the Cuban delegation at the San Francisco Conference. Carlos Eduardo Stolk of Venezuela, at 34, was the youngest representative on the Council. The Peruvian delegate, Alberto Arca Parró, was one of his country's most distinguished statesmen: a Doctor of Law of the University of San Marcos and the University of Indiana, highly appreciated as a notable statistician and the efficient author of initiatives in favour of the most under-privileged sectors. He was Presi-

dent of the Senate of his country and was elected Vice-President of Peru in 1962.

Czechoslovakia was at that time living through the last few months of its old regime, and time was running out for Benes and Masaryk. Jan Papanek, who had been trained in the disciplines of political science and international law at Paris and The Hague, was the country's first Permanent Representative to the United Nations. The Soviet Union's delegate was an Armenian, Amazasp Arutiunian: a brilliant and keenly intelligent man.

Presiding over this group of aces of international life and dominating them all with his authority and efficiency was a man with the brain of a computer, a will of steel and a heart of gold: Sir Ramaswami Mudaliar from India. I don't know if it was because I was a beginner in these matters, but this man with the scarlet Brahman caste mark on his forehead who hustled through resolutions with unbelievable speed seemed to me like some fabulous Oriental conjuror. He occupied the Presidency of the Council as of right, after already having been Chairman of the commission at the San Francisco Conference which drafted the chapter of the Charter on economic cooperation. Years later, he came back to the Council and consented to be Vice-President under me and to chair the Economic Committee: clear proof of his sterling simplicity and sense of cooperation.

At this session, the Economic and Social Council concentrated almost all its efforts on the task of dealing with the tremendous problems caused by the war. To this end, it set up the Economic Commission for Europe and the Economic Commission for Asia and the Far East. These were the first two institutions

of this kind set up by the United Nations and were designed essentially for reconstruction and rehabilitation, so that they were of a transitional nature.

The Economic Commission for Europe was entrusted to Gunnar Myrdal, a notable sociologist and economist and later the winner of the first Nobel Economics Prize. His appointment was extremely valuable, for his fame as an economist extended even to the Soviet bloc, which was just beginning the Cold War. Myrdal himself said: "this was perhaps the last chance to adopt a decision of this nature", and indeed for several years that Commission was the only United Nations body in which the Socialist countries took part, serving as an economic link between East and West.

I should also like to recall that the Council implemented the terms of article 71 of the Charter, which provided for consultation with non-governmental organizations. For this purpose, it approved a list of organizations enjoying consultative status, divided up into various categories according to their importance. Those in the first category were entitled to take part in the Council's debates, without right of vote, if the Council considered this useful.

Finally, with regard to the first meeting of the Economic and Social Council, my personal feeling was that in view of the select and experienced membership of the Council and the fact that its agenda was somewhat outside my own experience, although I had studied the reports carefully, all I could do was to listen and learn.

I continued in the Economic and Social Council for the next four years and acted as its President in 1950, subsequently acting as a member of the Security Council in 1952.

II

The establishment of ECLAC

As I analysed the debates and decisions I witnessed in the Economic and Social Council, this confirmed my impression that, in spite of the palpable tensions that existed, there was a strong desire among the Latin American delegates to take advantage of the possibilities that the United Nations system offered to reconstruct and rehabilitate the vast devastated areas.

It was 1947, and the Cold War had not yet reached its height.

I had come to the Economic and Social Council imbued with the idea of doing something useful for my country and for Latin America, where an economic crisis and social tensions stemming from the world conflict were already making themselves felt.

My first experiences at the February 1947 session, however, gave me the feeling that the world of the Great Powers had other concerns—which was understandable—and that Latin America was viewed as a fortunate region which had been spared the horror of bombardment and mass slaughter and the anguish and humiliation of foreign occupation, so that it did not need special attention.

For my own part, however, I mused that in Latin America millions of human beings were living in a state of deprivation comparable with that of the sectors most severely affected by the world catastrophe; that there seemed to be no prospect of improving their lot; and that it was unjust that the world did not even think about them. I also felt that it was a mistake to separate the problems of reconstructing the devastated areas from the development problems of the vast economically backward areas of the world, since it would be a very good idea to raise the consumption capacity of the Latin American countries in order to help rehabilitate the European economy. In Latin America, two-thirds of the population lacked purchasing power and were living outside the trade circuit, whereas before the war this part of Latin America had had flourishing trade relations with the Old World which had now virtually disappeared.

I also felt that the United Nations was obliged under the terms of its Charter to tackle as of now the problem of the economic development of areas with weak and backward economies—which accounted for two-thirds of the world's population—and that Latin America had every right to demand that the organization set up at San Francisco should help it in the difficult task of raising the standard of living of its inhabitants. It therefore seemed to me that the true role of Latin America in the United Nations was to draw attention to these facts and make every effort to ensure that our region too should receive the benefits of international cooperation. I timidly put forward the question of our needs and rights during the discussions on the establishment of the Economic Commission for Europe and the Economic Commission for Asia and the Far East, and on the Report of the Commission on Economic Affairs and Employment.

I did not present any concrete proposals, because I sensed that this would be inopportune at a time when attention was centered on relieving the terrible consequences of the war, but from that moment on I began to think that in July, when the Council met again, it would be necessary to do something to in-

duce the United Nations to deal with the problems of Latin America. However, I had to put off the idea of working on a project of this type, because shortly after the Council session ended I had to take part in the Special Assembly on Palestine and the Ad Hoc Committee to draft the Universal Declaration of Human Rights.

The fifth session of the Economic and Social Council began on 19 July 1947, with a well-filled agenda. I do not intend to describe the Council's work at each of its sessions in detail. If I did so regarding the previous session it was with the aim of giving an idea of the conceptual and human context that confronted me in my first encounter with the substantive work of the United Nations in the economic and social sphere.

As I already mentioned, I had conceived the idea of proposing the establishment of a commission to deal with the problems of the economic and social under-development of our region. In the Agenda proposed by the Secretary-General for that session, however, there was no item that could cover a proposal for the establishment of a new regional economic body. In order to do so, it was necessary to ask in advance for the inclusion of a new item on the agenda. The time limit for such a request was very close, and there was no time to consult with my Ministry of Foreign Affairs in detail. All I could do was send a cable to the Minister of Foreign Affairs of Chile informing him that unless otherwise ordered I was going to put forward within two days a motion for the establishment of an Economic Commission for Latin America. I did not receive any order to the contrary, and neither did I receive any instructions in the matter. In view of this, on 12 July of that year I officially submitted to the United Nations Secretary-General a draft resolution for the establishment of an Economic Commission for Latin America, for him to transmit it to the Programme Committee of the Council. The grounds put forward in the draft resolution were that Latin America had entered into a serious crisis as a result of the economic efforts made in support of the United Nations' cause during the war and the disturbances caused in the world economy by that conflict, so that it was necessary to develop the industries of the Latin American countries and make the fullest use of their enormous natural resources in order to raise the standard of living of their inhabitants, help to solve the economic problems of other continents, secure a better balance in the world economy and further international trade, to which end the

proposed Commission should study the measures needed to facilitate joint action to favour the economic progress of the Latin American countries and raise the level of their economic activity, as well as to maintain and intensify the economic links among them and with the rest of the world and participate in the application of such measures.⁸

In the time between the inscription of the item and its consideration by the Council, my delegation carried out intensive activities to sound out the prevailing atmosphere and promote our draft, seeking to interest the largest possible number of delegations in it and neutralize those that appeared to be opposed to it. Even before the Chilean proposal began to be discussed in the Council, however, it seemed clear that there was little chance of it being approved. The idea that had inspired the proposal ran counter to too many prejudices and deep-rooted mental and ideological schemes for it to be accepted right away without difficulty. Furthermore, it was not in keeping with the system of priorities followed in practice by the Council and meant dragging the latter deep into a new field—the development of countries with weak and backward economies and low standards of living—which the Great Powers were in no hurry to enter. For them, the reference in the San Francisco Charter to the obligation to take individual and collective measures to promote economic and social development all over the world was no more than an expression of distant and rather vague intentions, and the way to put it into practice was merely to bring the situation back to what it had been in 1939.

The soundings made confirmed my fears. The opposition of the United States, the Soviet Union, the United Kingdom and France had to be taken for granted, and it was also necessary to add to them Canada and New Zealand, in view of their known opposition to any regional approach to the economic problems of the world. In short, from the very beginning eight of the 18 member countries had to be considered as opponents of the project, including the powers without whose consent nothing had yet been approved in the United Nations.

The three Latin American States which, together with Chile, represented the region on the Economic and Social Council could naturally be expected to support our initiative.

In preparing our proposal, I ran into an unexpected obstacle: the United Nations did not have any study, report or analysis of the Latin American economy or of the situation of the individual countries which could serve to back up our demand. Nor was it possible to enjoy the services of the Secretariat of the Inter-American Economic and Social Council, although in principle it had been functioning since 1945, when it was set up by the Chapultepec Conference.

Thanks to the assistance of my brother, Alfonso Santa Cruz, who was subsequently a United Nations official and Deputy Principal Director of ECLAC and who had just completed his post-graduate studies in the Economics faculty of Harvard University, I was able to assemble important data on national income, foreign trade, agricultural, mining and industrial production, living standards of the population—wages, nutrition, housing and clothing—, etc.

On 1 August 1947, the day our proposal was due to be discussed, it fell to me to open the debate. In my statement, I set forth a dramatic picture of the economic and social situation of our countries, as reflected in the data I had collected. This was followed with considerable interest: it was the first time the economic and social situation of Latin America had been set forth in the United Nations, and although the information on which it was based was naturally very incomplete it had sufficient impact to convince the members of the Council that our region was suffering from such a state of backwardness and need that it deserved just as much special attention from the United Nations as the continents which had gone through the horrors of the war. I then went on to mention the decisive contribution made by Latin America to the Allied victory because it had supplied them with oil, copper and other minerals, wheat, sugar, coffee, cotton, wool, nitrates, etc. at low, frozen prices, whereas manufactures—including the capital goods which it had not been possible to acquire during the war—were now costing high prices that rose higher every day. I pointed out that the world conflict had seriously affected Latin America because it had prevented it from renewing its industrial plant, which was now obsolescent, and had distorted the direction and rate of its incipient industrialization. I forestalled some of the objections that I foresaw by pointing out that there was no risk of duplication of the functions of the Inter-American Economic and Social Council because the proposed

⁸ Official Documents of the Economic and Social Council, second year, fifth session.

Commission would study the problems of our geographical region in the light of the world economy and, moreover, would coordinate its activities with the other regional commissions. I also analysed the possible arguments that the existing commissions represented temporary, transitory exceptions dictated by the need for reconstruction, pointing out that there would be basically no real difference between the terms of reference of those bodies and those proposed for ECLAC, since it was obvious that those other commissions should also seek to promote the economic development of the countries under their jurisdiction because of the inseparable links between actions to promote the economy and actions to repair what had been destroyed.⁹

The representatives of Cuba and Venezuela immediately seconded the Chilean motion, endorsing the arguments put forward and adding others which were extremely convincing.¹⁰

The impact produced on the Council by the statements of the three Latin American delegates was obvious when Willard Thorp, the United States representative, said that they had made "a great impression" and that he "did not want to make a pronouncement in favour of the proposal or against it, but merely requested that the decision should be postponed". He based his position on the arguments that the Council had only heard the views of three of the twenty countries of the region; that the Pan-American Conference was to meet in January 1948 to discuss how to organize inter-hemispheric cooperation in the economic and social fields, and that in such circumstances everything made it advisable to wait for the views of that Conference.

⁹ As foreseen, the Economic Commission for Asia and the Far East was turned into a permanent body which, after a few years, dealt fundamentally with development. The Economic Commission for Europe was also given permanent status and proved to be very useful for improving economic and trade relations between Eastern and Western Europe.

¹⁰ Guillermo Belt stated that in two years of operation the Inter-American Economic and Social Council had not been able to do any useful work because it lacked the necessary financial and technical resources. The Venezuelan delegate, Carlos D'Ascoli, —a brilliant politician and an excellent economist— drew attention to Latin America's economic dependence, citing his own country and the case of petroleum as an example that showed how urgent it was to diversify production and guarantee commodity-producing countries fair treatment in terms of stable and remunerative prices, which called for intervention by the United Nations.

The Canadian delegate Paul Martin then took the floor to enlarge on the arguments of his United States colleague and to repeat his country's opposition to the regional-level consideration of economic matters. His statement was perhaps the most serious attack on the proposal and at the same time the most subtle.

The Soviet delegate's statement was brief but categorical. He said that "he did not feel that the establishment of an Economic Commission for Latin America was a pressing need" and that in his opinion it was not fair to draw an analogy with the Economic Commissions for Europe and Asia and the Far East, since both those bodies were designed to provide effective aid to countries ravaged by the war. He therefore said that he regretted that he could not support the Chilean representative's proposal.

The debate ended with very eloquent and significant statements by Charles Malik, of the Lebanon, and M. Nehru of India. The first-named delegate expressed his complete agreement with our proposal and also noted the similarity between the problems of Latin America and those of the Middle East. The Indian representative, for his part, said that he unreservedly supported the Chilean representative's proposal and suggested that a working group should be set up to study the matter, if that were acceptable to the Latin American countries.

The first day's debates thus drew to a close in an atmosphere which was markedly favourable to our aspirations. The United Kingdom and France had remained silent, the arguments put forward against the motion by the United States were of a procedural nature, and no-one except the Canadian delegate had rejected the basis of the idea. However, the crafty proposal by the United States delegate that it was necessary to await the views of all the Latin American countries at the Pan-American Conference was quite effective and undoubtedly represented an obstacle as serious as it was unexpected.

When the debates resumed four days later, our hopes began to wane. Although some Latin American countries such as Uruguay and El Salvador had sent communications in favour of our proposal and the Ambassador of Bolivia, Humberto Palza, had made an ardent speech in favour of the establishment of the Commission, the United Kingdom delegate firmly opposed it and other countries proposed compromises that meant its postponement. It was suggested that first of all studies should be made of the Latin American economy: a proposal which I ac-

cepted without prejudice to the establishment of the Commission. I also said that I was in agreement with the discussion, in a small group, of the idea of setting up an Ad Hoc Committee to study our motion in the coming months and submit a report to the sixth session of the Council, scheduled for February 1948. My suggestion was rather coldly received, however.

It was then that the event which was to prove decisive for our proposal took place. The French delegate, Pierre Mendès-France, who had not yet made any official pronouncement on the matter, privately expressed to me his great sympathy for our initiative, adding that he would be willing to ask his Government for authorization to vote in favour of the idea of setting up an Ad Hoc Committee, as proposed by Cuba, with some modifications suggested by me, provided that we accepted European countries among the members of that Committee. I immediately replied that, as I had explained to the Council, our conception of the body we were seeking to establish was as an instrument for cooperation not only among our own countries but also among regions: i.e., among all the different areas of the world. I added that the Inter-American Economic and Social Council already existed for the study of Latin American problems in relation to the United States, but our aim was to open up the Latin American economy to the whole world, which was why we had brought the matter to the United Nations, and in those circumstances we would not only accept the inclusion of European countries in the Ad Hoc Committee but also in the Economic Commission itself, if it was set up.

While I never imagined that my assertion would come as a surprise to Mendès-France, his extremely acute political sense caused him to react with astonishing speed. Without the slightest hesitation he said: "You can count on the support of all the European countries for the establishment of the Commission, and our support will begin by favouring the formation of a drafting group, as you suggested".

That very same day, the Council designated the group in question, which rapidly reached agreement. Three days later, it presented the Council with a draft resolution providing for the establishment of an Ad Hoc Committee made up of Chile, China, Cuba, France, the Lebanon, Peru, the United Kingdom, the United States and Venezuela, with the mandate of considering the factors that could be of influence in the establishment of an Economic Commission for Latin America. It also authorized the Committee to

begin consultations with interested bodies inside and outside the United Nations and instructed it to seek the views of the Ninth Pan-American Conference, to be held in 1948 in Bogota. In the meantime, the Secretary-General was to initiate a study to define and analyse the economic problems of Latin America "which threaten the stability and development of its economy".

Thus ended the intense and absorbing debate which represented an extremely positive first step. We had not managed to actually set up the Commission, but we had won a very important partial victory by securing the designation of a group, with a majority of members favourable to the Commission's establishment, which was to formulate recommendations to the Council. We had also managed to draw the latter's attention to the economic situation of Latin America, which it spent many hours considering. For the first time, the United Nations Secretariat was to be responsible for going into these problems in depth and allocating special resources for the relevant studies, and the great problem of the economic development of the weaker areas was finally to break out of its previous isolation in specialized libraries and in some forward-looking universities.

The second session of the United Nations General Assembly began in September 1947. Its Second Committee—that responsible for economic and financial questions—, made up of the 55 countries which were then members of the Organization, had on its agenda the consideration of the annual report that the Economic and Social Council had to submit to the Assembly on its activities.

The Chilean delegation, for its part, assumed that there was a tacit commitment among the members of the Council to await the results of the Ad Hoc Committee's examination of the project on the Latin American regional body. This attitude of impartiality was strengthened by the fact that the General Assembly did me the honour of electing me Chairman of the Second Committee, which to some extent obliged my delegation to refrain from taking part in particularly controversial discussions. Unforeseeable events, however, meant that the Assembly dealt with our initiative and adopted a resolution which represented a very timely shot in the arm for us. In the course of the general debate on the report of the Council, almost all the Latin American representatives referred to the proposed Commission, praising the idea and expressing the view that such a body needed to be

established. A dozen countries from other geographical areas expressed similar views and, in general, the delegates of all the economically weak nations spoke of the need for the United Nations to cooperate actively with governments in the promotion of their economic and social development policies, especially through regional bodies such as those that already existed for Europe and for Asia and the Far East.

The Middle Eastern countries, headed by Egypt and the Lebanon, considered that the consensus of views revealed in the general debate should be expressed in a more concrete form. They therefore presented a draft resolution whereby the Assembly invited the Economic and Social Council to study the factors relating to the establishment of an Economic Commission for the Middle East. Among the grounds for this proposal they included two preambular paragraphs which referred to the proposed Economic Commission for Latin America in the following terms:

“3. *Noting with satisfaction* the Council’s decision at that session to establish an ad hoc committee to study the factors relating to the establishment of an economic commission for Latin America;

“4. *Noting* the favourable reception given by the Second Committee to the proposal to establish an economic commission for Latin America...”

This resolution was adopted by a large majority, although some countries, especially those of the Communist bloc, unsuccessfully opposed the inclusion of the preambular paragraphs referring to the Economic Commission for Latin America.

When the Report of the Second Committee was dealt with in the Plenary of the Assembly, the Soviet delegate, Amazasp Arutiunian—one of the ablest and most combative representatives that country has had in the United Nations—unexpectedly took the floor and proposed the elimination of the fourth preambular paragraph, arguing that “the question of the establishment of a regional economic commission for Latin America should be objectively analysed by the competent United Nations organ”. He added that the adoption of that paragraph would be “tantamount to trying to exert pressure on the Economic and Social Council” and, in order to show that the Soviet Union’s position on the matter was clear-cut and final, he said that if preambular paragraph four of the resolution were retained, his delegation would be obliged to abstain in the final vote on the draft.

I immediately asked for the floor in order to reply to the Soviet delegate’s statement. I said that Chile had expressly stated in the Committee that it would not present a specific motion for the Assembly to support the establishment of the regional body for Latin America, because the Chilean delegation felt morally committed to respect the understanding reached with the Council, but now, after the persistent attacks made on the preambular paragraph, which merely took note of an actual fact—the “favourable reception given by the Second Committee to the proposal”—, Chile felt obliged to call for its retention, since a negative by the Assembly regarding that paragraph would give the impression that it did not view with sympathy the idea of setting up the Commission. It would mean denying the true and undoubted fact that, in addition to the 20 Latin American countries, eleven other nations had spontaneously offered their support in the Second Committee, and it would amount to rejecting what had already been done by the Economic and Social Council.

There were no further speakers in this controversy, and the President (the Brazilian delegate Oswaldo Aranha) put the resolution to the vote. The result was as follows: the first paragraph was approved by 49 votes in favour, none against, and no abstentions, while the fourth preambular paragraph was approved by 35 votes in favour, seven against (six by the Communist countries and the seventh by an unidentified country), and six abstentions (the United States and some of the British Commonwealth countries). The resolution as a whole was adopted by 43 votes in favour, none against, and the abstentions of the Soviet Union, the Ukraine, Byelorussia and Yugoslavia.

After that meeting of the General Assembly, the possibilities of setting up the Economic Commission for Latin America were much brighter, and indeed, once the General Assembly had embarked upon its great debate on economic development, this matter became one of the main items of discussion at the annual meetings.

The Ad Hoc Committee designated by the Economic and Social Council held two sets of meetings: one in October of that same year, during the General Assembly session, and the second in January 1948, a few weeks before the opening of the sixth session of the Council. At the first meeting, which dealt with the organization of work, the Ambassador of Venezuela, Carlos Eduardo Stolk, was elected Chairman. The Secretary-General was represented by Harold

Caustin, a British economist who was one of the best-organized men I have met in international economic circles. Together with David Weintraub, Principal Director of the Economics Department, he was an important factor in the creation of ECLAC and watched over its first years of life with an eagle eye. It is only fair to recall that both of them acted under the instructions and with the decided support of David Owen, the Deputy Secretary-General for Economic Affairs.

The four Latin American representatives on the Committee had previously prepared a document on "the main causes of the maladjustments in the Latin American economy". For its part, the Secretariat had completed (under the direction of Weintraub and Caustin) the study requested from it in the July 1947 resolution.

This latter work was as complete as could be expected in the circumstances. Naturally, it was of a very general nature because of the short time available for its preparation and the shortage of statistical information. The Secretariat itself was aware of these limitations and entitled it "Review of economic conditions in Latin America". Nevertheless, it contained a very approximate assessment of the characteristics of agriculture, mining and manufacturing, as well as the factors affecting industrialization, and it concluded with a chapter on the main problems affecting the economic life of the countries in question, including industrial production, external trade and inflationary trends. It was also accompanied by some statistical data on the cost of living, population, per capita exports and imports, roads, railways, etc. This "review" of the economic conditions of the region fully confirmed the picture which the Latin American delegates¹¹ had drawn for the Council. Its main merit was that it was the first study made at the international level on the Latin American economy as a whole.

The working paper presented by the four Latin American delegates detailed the factors which they considered to be responsible for the serious economic imbalances suffered by the countries of that region and the effects that the war had had on its economy. They went on to formulate conclusions on the basis of the facts set forth, among which it is worth reproducing here one which, in spite of its brevity, is very close in many respects to the current diagnosis of the economic ills of Latin America and the main lines of a policy for eliminating them:

"It is not worth trying any remedy for the economic imbalances (of Latin America) unless it is based on a broad and coordinated policy of economic and social development designed to raise the standard of living of the population, to diversify the economies, to promote foreign trade, to modernize the technology used in agriculture, industry, transport and trade, to make the fullest use of the region's natural resources and promote intra- and inter-regional trade, and to stimulate the formation, availability and proper use of capital".

The document ended by proposing the basic points of the tasks that should be entrusted to the organization which it was desired to set up, which were practically the same as those in Chile's original motion and were later incorporated in the resolution establishing ECLAC.

While the Ad Hoc Committee was still meeting, it became known that the Ninth Pan-American Conference, which was to be consulted as to the advisability of setting up the proposed Commission or not, had been postponed from 17 January to 30 March 1948. On hearing this, the four representatives of Latin America held that such consultation was a purely formal requirement which had now lost all importance, since in the General Assembly all the States of that region had come out in favour of the project, which now had the report of the Ad Hoc Committee as its basis for action. It was necessary to accept a compromise: instead of the views of the Conference, it was decided to request those of the Inter-American Economic and Social Council, which was to be sent the provisional report of the Ad Hoc Committee in due course, and the Secretary-General of the Pan-American Union, Dr. Alberto Lleras Camargo, would be invited to attend and give his views.

On Christmas Eve, I travelled to Chile to discuss various matters with my government, including the question of the economic commission. The Minister of Foreign Affairs was Germán Vergara Donoso, a career diplomat with long experience in the foreign service who had been one of the delegates to the San Francisco Conference and also to the Preparatory Commission and the first General Assembly. He had firmly supported my actions in the United Nations, as had President González Videla, but he evidently feared that if there were too much controversy this might adversely affect Chile's position in inter-American circles, and he said something to me which

¹¹ The representatives of Chile, Cuba, Peru and Venezuela.

faithfully reflected the climate of uncertainty that surrounded the United Nations in those early days: "Take it easy and go very carefully. Remember that the United Nations is a new institution that may end any day, whereas the Pan-American Union has withstood half a century of difficulties and is something solid and permanent that we have the duty to defend and preserve".

On the way back to the United States I stopped over in Peru and Venezuela in order to ensure the firmest support from their governments. In Peru, I talked to Foreign Minister García Sayán, who promised that the Peruvian delegates would take a firm position in favour of the economic commission.

The Ad Hoc Committee met again on about 10 January 1948. It began its work by hearing statements from the representatives of the FAO and the American Federation of Labor, both of whom were openly in favour of the proposal. It then heard Dr. Lleras Camargo, who had accepted the invitation to attend. I remember that I travelled with him from New York to Lake Success and we talked about the matter which had brought him to the United Nations. I was worried that his report might be unfavourable, for I felt that it was only natural that, as the head of an inter-American institution, he might be afraid that the proposed new body might interfere with the work of his own organization and reduce its importance. That would be a serious matter, for Dr. Lleras Camargo was one of the main political figures in the hemisphere. Already, at the San Francisco Conference, which had been attended by the most important statesmen in the world, he had stood out on his own merits. Very soon, however, I understood that my concern showed that I had failed to appreciate his qualities as a true statesman. In the Committee, he confirmed all that we had said about the economic and social conditions of Latin America and declared that it was essential to stimulate international cooperation in order to improve those conditions. He said that it was not for him to say whether the new organization should be set up or not, for that decision belonged solely to the organs of the United Nations, but he categorically asserted that if it was set up, then there was no reason why it should overlap with the functions of the Inter-American Economic and Social Council if precautions were taken to ensure suitable coordination between the two bodies. Dr. Lleras Camargo's statement did away with one of the most serious doubts that had been raised during the pro-

cess of discussion and represented a new and powerful element to help convince the Committee in favour of our proposal.

On 15 May 1947 the Inter-American Economic and Social Council discussed the consultation made to it by the Committee. I was invited to the Council's meeting in Washington and attended in order to explain the project and the reasons underlying it. The only objections raised at that meeting concerned the supposed undesirability of allowing countries from outside the continent, such as the European countries, to take part in the work of economic cooperation bodies for our geographical region. Some delegates thought that this would amount to the unacceptable recognition of colonial interests in America. I replied that I fully shared their anti-colonial feelings and favoured the definitive elimination of colonialism from the whole world and especially from our own hemisphere, but the presence of European countries in the Commission was advisable and even necessary if it would further the strengthening of our countries as part of the world economy and help to restore Latin American-European trade, which had practically disappeared during the war. I also pointed out that the existence of a body of this type within the United Nations would do away with the fears that existed in other areas that Latin America was seeking economic autarky, which would be extremely harmful and contrary to the spirit of universal cooperation. I added that the participation of three European nations in a body where the countries of the Americas were in the overwhelming majority could not represent any danger to the interests of the latter but, on the contrary, would tend to bring a certain degree of balance to the very unequal association between Latin America and its big brother to the North.

Five days later, Dr. Lleras Camargo himself transmitted to the Chairman of the Ad Hoc Committee, Carlos Eduardo Stolk, the resolution adopted by the Inter-American Economic and Social Council, which stated flatly that that body had decided to support the immediate creation of the proposed Economic Commission for Latin America.

This was the *coup de grâce* for the opponents of the project. The very Council whose existence had been adduced as an argument to prove that it was not necessary to set up a regional commission within the United Nations had now declared that it supported the "immediate creation" of such a body. After this, it was obvious that the Council would be duty bound to

make a recommendation favourable to the establishment of ECLAC, and it therefore made a paragraph-by-paragraph examination of the draft report prepared by the Secretariat (in which the deft hand of Harold Caustin was to be glimpsed), although it never formally discussed the specific point that it was supposed to clarify to the Ad Hoc Committee: whether the new body should be set up or not.

Thus, after the approval of paragraph after paragraph, it came to the last of all, which included nothing less than a draft resolution to be adopted by the Council, establishing the Economic Commission for Latin America and setting out its composition and terms of reference. In reality, every one of the sections of the report, from the first one onwards, inescapably led to this conclusion.

The sixth session of the Economic and Social Council had begun on 2 February 1948, and on 19 February it began the discussion of the report of the Ad Hoc Committee.

After Stolk himself, the speakers were the author, the new and highly competent representative of Peru, Juvenal Monge, who later attended the first sessions of ECLAC and was its first Rapporteur to the Council, and the delegate of Brazil, Ambassador João Carlos Muniz, whose country had been elected to the Council in the place of Cuba.

All of us warmly approved the report and put forward fresh elements to show that the need to set up the new regional cooperation organization had become even more pressing in the months that had elapsed since the matter began to be discussed. I recall that Ambassador Muniz, when presenting the important views of his country, which had not yet been heard in the Council, brought in a concept which was novel then but is now universally accepted and was expressed in the Punta del Este Charter in 1961. He said that Latin America must engage in an exercise of "regional planning" in order to emerge from its backwardness and secure the indispensable economic complementation among all countries, and that could only be done satisfactorily through a United Nations body specializing in the problems of the region.

Afterwards, statements were made in the same sense as our own by the representatives of France, the United Kingdom, the Netherlands, Australia, New Zealand and China. A surprise to everyone was the fact that similar views were expressed by the representative of Poland, the eminent economist Professor Oscar Lange, who had been a distinguished

member of the international scene for years. It is worth noting that in those days Poland never took a different line from that of the Soviet Union in the United Nations. Canada, the United States and the Soviet Union stated that they had abstained from voting and explained their reasons for doing so. George Davidson, the Under-Secretary of Health of Canada, who was one of the most efficient and ingenious men who were ever on the Council, repeated almost the same arguments put forward six months earlier by Minister Paul Martin: Canada maintained its opposition to the establishment of regional commissions. Willard Thorp obeyed instructions which, I imagine, he did not fully agree with, and his statement was therefore the weakest and shortest possible. His final words summed up his country's position: "The United States will abstain, because voting for the establishment of this Commission could be taken to mean that it is not concerned over the possible duplication of functions with the bodies of the inter-American system, while voting against the motion could appear to indicate that it overlooks the fundamental problems which call for a solution". The Soviet Union was a little more precise. Its delegate, Arutiunian, said that the establishment of this new body seemed "uncalled-for" from the point of view of the "organization" of the Council's work, because there were already bodies which could deal with the problems that it was aimed to solve, and also because "since it is a fact that in Latin America there has not been any destruction caused by the war, there does not appear to be any urgent need, as is the case in the Far East and Europe". He added that "Since the Latin American countries continue to be convinced of the need for the proposed Commission, however, the Soviet Union will withdraw its objections, because it understands the difficulties that are an indirect result of the war, and especially the generally insufficient level of economic development of that region".

When the general debate was closed at the request of the delegate of Canada, the item was transmitted to the Economic Committee of the Council so that it could study in detail the draft resolution proposed by the Ad Hoc Committee. In my capacity of First Vice-President of the Council, I acted as Chairman of the Economic Committee.

No major problems arose, except for the attempts by the Soviet Union to secure its acceptance

as a member of ECLAC and its insistence that Santiago, Chile should not be the location of the new institution. The Soviet delegate argued that there was no reason why his country should not be a member of the Commission when the United States, Canada, the United Kingdom, France and the Netherlands had all been given the right of membership. With regard to the problem of the location of ECLAC Headquarters, the reason for the Soviet Union's opposition—although it refrained from saying so—was none other than the fact that diplomatic relations between the Chilean Government and the Soviet Union had been broken off a few months earlier.

The final stage of this absorbing process took place on 25 February 1948, when, in a few brief words, I informed the Council on behalf of the Economic Committee that the latter body had approved

the text before it, with two or three small drafting changes, and now submitted it to the Council for its final decision. There was a short debate on a Soviet amendment to restore the provision that that country should be a member of the Commission, but the amendment was rejected by 13 votes against it, two in favour, and two abstentions. The resolution itself was then put to the vote, the result being 13 votes in favour, no votes against it, and four abstentions (Byelorussia, Canada, the United States and the Soviet Union).

The Economic Commission for Latin America had been born. Its first session was held in Santiago, Chile, in June 1948, and its first Executive Secretary was the Mexican diplomat Gustavo Martínez Cabañas.

(Original: Spanish)

Human rights *and the child*

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The current celebration of the fiftieth anniversary of the founding of the United Nations is a suitable moment for reflection and analysis of the Organization's role in promoting, guaranteeing and defending human rights.

Although the promotion of human rights was already referred to in the Charter of the United Nations (1945), the real political commitment to this ideal was only expressed with the adoption and proclamation in December 1948 of the Universal Declaration of Human Rights, which recognizes the inherent dignity and equal and inalienable rights of all members of the human family.

The Universal Declaration was to be complemented with a text detailing the commitments to be assumed by States in order to effectively guarantee the basic principles of the Declaration. Eighteen long years of debates were to ensue in the United Nations, however, before those principles attained their desired concrete expression. Instead of adopting a single text, the States chose to differentiate between civil and political rights and economic, social and cultural rights, finally adopting in 1966, with an interval of three months between them, the International Covenant on Economic, Social and Cultural Rights and the International Covenant on Civil and Political Rights.¹ These covenants

¹ The "International Bill of Human Rights" is made up of the Universal Declaration of Human Rights, the International Covenant on Economic, Social and Cultural Rights, the International Covenant on Civil and Political Rights, and the Optional Protocol to the latter.

adopted in 1966 required a further ten years for their effective entry into force, and even now efforts are still being made to secure their ratification by all the Member States of the United Nations.²

In the course of those years, new human rights instruments have also been adopted for the detailed regulation of some of the principles and guarantees contained in the Universal Declaration and the Covenants, among them the International Convention on the Elimination of All Forms of Racial Discrimination (1965), the International Convention on the Elimination of All Forms of Discrimination Against Women (1967), and the Convention on the Rights of the Child (1989).

1. The Convention on the Rights of the Child: an instrument of human rights

On 20 November 1959 the United Nations General Assembly proclaimed the value and dignity of the child as a human person and the need to give children the necessary protection for their growth and development. Exactly thirty years later, on 20 November 1989, the General Assembly adopted a new instrument to protect the human rights of children, but this time in the form of a legally binding convention that the ratifying States are obliged to fulfil.

² The International Covenant on Economic, Social and Cultural Rights has been ratified by 131 States, while 129 States have ratified the International Covenant on Civil and Political Rights.

Within less than five years of its adoption, this Convention became the most fully ratified human rights instrument in history. Within less than a year of its adoption it had already been ratified by over 130 countries (179 States by September 1995), and it is expected that –sooner rather than later– it will become the first truly universal law. No other agreement or convention on human rights has won so many adherents in such a short time, and some feel that this Convention is one of the greatest successes of the United Nations in its fifty years of existence. The Convention has received the support of famous world leaders, but perhaps one of the most important expressions of support has been that received from the Plenary of the World Conference on Human Rights held in Vienna in 1993, when, for the first time ever in a world declaration, an appeal was made for the universal ratification of a human rights instrument by a specific date: 1995.

Why has there been such unusual support for a human rights text which was the last to be adopted but which now enjoys the distinction of having obtained the highest number of ratifications?

The adoption of the Convention in 1989 and its astoundingly rapid ratification in its first year are intimately related with the international climate of the end of the Cold War, the assertion of democracy in countries which had been under the yoke of military dictatorships, and the greater understanding and support for struggles for the equality and dignity of all human beings, as represented, among others, by the efforts of Mandela in South Africa. It has also been a time in which some countries have belatedly become aware of the perverse effects of ruthless macroeconomic policies and cold-blooded structural adjustments.

These years have been characterized by the repeated reassertion of the importance of respecting human rights. During the first five years of this last decade of the century and also of the millennium, the leaders of the nations of the world, representing mankind as a whole, have met several times at great world conferences to express their concern over the serious problems that afflict humanity and to pledge their best efforts to guarantee the effective exercise of and respect for human rights. The declarations adopted at the World Conference on Education for All (Jomtien, 1990), the World Summit for Children (New York, 1990), the United Nations World Conference on Development and Environment (Rio de

Janeiro, 1992), the Conference on Population and Development (Cairo, 1994), the World Summit for Social Development (Copenhagen, 1995) and the Fourth World Women's Conference (Beijing, 1995) all single out respect for the human rights of all peoples as a basic condition for peace and development.

In spite of the threats posed to these rights by the outbreak of ethnic and religious confrontations within rather than between countries, many sectors of society have clearly expressed their interest in reaffirming the idea of the equality of all human beings and the need for equity in political and economic affairs.

It is in these same years that organizations such as the World Bank and other multilateral and bilateral cooperation agencies have been showing greater interest in this subject. Good government and the need for the introduction of structural changes to improve the living standards of the poor, satisfy basic needs and ensure respect for human rights in their broadest sense of both civil and political and economic, social and cultural rights are beginning to form a sort of obligatory condition for gaining access to cooperation. It is thus becoming clear that respect for human rights is now considered the basis for peaceful coexistence, security and peace and an essential condition for development and economic and social progress.

Some may perhaps feel that there is something of empty rhetoric and even of hypocrisy in these new expressions of interest in human rights. Partly responsible for this attitude are the erratic policies and odious differentiations that some countries –including some of the most powerful ones– apply in their relations with nations where there is gross contempt for and violation of human rights. These differences of treatment have nothing to do with the seriousness of the violations of human rights, but are dictated by the powerful economic interests of investors and traders who fear that their market access will be restricted and are concerned over the possible advantages of their competitors.

In spite of all these criticisms, valid though they may be, it must be acknowledged that there is now a high level of attention and awareness by national and international public opinion regarding the seriousness of occasional or systematic violations of human rights. The governments of the world feel that they are under the scrutiny not only of the United Nations bodies responsible for overseeing human rights but also of a considerable number of non-governmental

organizations which seek out and denounce violations. The way States treat their own nationals has ceased to be a matter of the exclusive concern of sovereign States and has now become a legitimate concern of the whole international community.

In most countries, and even at the international level too, there is still a tendency to consider that violation of human rights only means the violation of the civil and political rights of adults. To some extent, this position has also been shared by some United Nations bodies and non-governmental organizations. However, this tendency is weakening because of the considerable importance increasingly attached to the awareness that in practice it is almost impossible to secure a climate of respect for the basic freedoms of the individual (his traditional civil and political rights) unless his basic economic, social and cultural rights are also respected.

Just as today the term "development" covers the dual aspects of economic growth and social development, in spite of the stubborn but outmoded resistance of those who still hold that high economic growth rates automatically bring social development with them, so the expression "human rights" covers not only civil and political but also economic, social and cultural rights and places the human person at the centre-point of the development process (UNDP, 1995). The international community already clearly understood this in 1966, when it adopted the International Covenant on Economic, Social and Cultural Rights, the Preamble of which states that the ideal of a human race free from fear and misery cannot become a reality unless suitable conditions are created to allow human beings to enjoy their economic, social and cultural as well as their civil and political rights.

It was precisely in this international climate of the rethinking of political priorities and keen interest in respect for human rights and their effective exercise that the World Summit for Children was held in New York in October 1990, attended by 71 Heads of State or Government who undertook to promote the ratification of the Convention on the Rights of the Child in order to turn it into a legally valid instrument in their countries and to formulate national action plans for children so as to achieve a set of specific agreed objectives, fundamentally in the areas of health, nutrition and child education.

The Declaration of Heads of State of the World Summit had a very big impact which was reflected

not only in the ratification of the Convention but also, and especially, in the formulation of national action plans which, by determining specific actions to be carried out within set time-limits to meet the quantitative and qualitative targets which had been agreed on, would constitute a strategy for the rapid achievement of some of the rights set forth in the Convention. Thus it was that the promises of governments to reach specific targets as regards the reduction of avoidable deaths, the reduction of preventable diseases, malnutrition and illiteracy, and increased coverage of primary education became the most efficient strategy for fulfilling the obligation to guarantee the right to life, to health, to adequate nutrition and to education which the States had assumed with their ratification of the Convention on the Rights of the Child.

2. The Convention on the Rights of the Child: the true rights involved

This Convention, which was adopted by the United Nations General Assembly only a few days after the fall of the Berlin Wall, is a true expression of the spirit of conciliation prevailing in international circles. After ten years of negotiations and consultations, the final text is the result of the agreement reached between the different conceptions with regard to life, childhood, needs, rights and obligations held by the various countries and their peoples, as represented by their governments, in line with their traditions, culture and religion, political and legal systems, and level of development. This means that the Convention establishes the minimum that all societies must guarantee to all children, and the text of the Convention itself therefore very wisely laid down that the application of its provisions must be subordinate to any other legal provision which better ensures the effective exercise of the rights of the child, whether such provision be contained in the domestic legislation of member States or in any other instrument of international law which is valid in the country in question.

The Convention reaffirms once again the legitimacy of the human rights of children. This reaffirmation might appear to be redundant, but in reality it is not so, for it was only after twenty years of this century had elapsed that children began to be recognized as human beings, with the same dignity as adults, thanks to the initiatives of Eglantyne Jebb, an

English children's rights activist. Up till then, children had been a "private matter" coming under the exclusive jurisdiction of the family. Children were not subjects of human rights, nor were they a matter of interest to the international community.

Although children were already recognized as subjects of law in the legislation of many countries, fundamentally in terms of the right to be protected against exploitation and abuse, the recognition of children as subjects of human rights is a recent development. We have now advanced past the stage of considering children as incomplete human beings or potential adults and childhood as a period of "training" for adulthood. Children are now recognized as values *per se*, with just as much dignity as adults, so that as well as enjoying the fundamental guarantees and freedoms of all human beings they also deserve special protection while their bodies and minds grow and mature.

The Universal Declaration of Human Rights had already established the rights of children to special care and assistance and to education, but as members of the human family children also have the rights which the International Covenant on Economic, Social and Cultural Rights and the International Covenant on Civil and Political Rights recognize as the birthright of all persons: the right to life; the right not to be subjected to torture, slavery or exploitation; the rights to health, to education, to have a name and nationality, and the protection which they must be given as minors.

The Convention united all these principles in a single text which is now considered to be one of the most advanced human rights instruments in existence and which incorporates the most progressive tendencies in this field. The Convention rises above the academic discussion on the priority of civil and political rights (the basic or fundamental freedoms) over economic, social and cultural rights, integrating them into an harmonious whole, and provides an indisputable platform for the promotion, defence and guarantee of the effective exercise of all rights for all children.

The Convention has had a strong influence in strengthening the consideration of children as holders of legal rights, thus not only guaranteeing them their rights but also ensuring the legitimacy of demands that those rights be satisfied. This represents a very important step forward, since it means that the satisfaction of their basic needs will no longer be the

result of the mere bounty or voluntary paternalistic well-doing of a generous State, but rather the fulfillment of the State's obligation to ensure that both parents and society as whole do their respective duty. In short, the existence of children's rights will no longer depend on the exercise of legal actions or on the skillfulness of the claimants in demanding their fulfillment, or on the capacity of those bound to fulfill those rights.

The Convention departs from the traditional concept whereby the child is seen as a passive subject who is the recipient of protective measures, although it fully recognizes the need for those measures. Taking a realistic and progressive view, it sees the child as an active subject with the right to express himself and make himself heard, in line with his age and degree of maturity, on the matters which concern and affect him. This is particularly important in administrative and judicial procedures concerning the parental custody of the child or the infringement of penal regulations.

The Convention does not establish an order of priority of rights, because all of them are important. There is no such thing as a minor right. The drafters of the Convention chose to assemble in a single legal instrument all the relevant rights, extending from civil rights (such as the right to a name; to a nationality; to the preservation of the child's identity; to freedom of opinion, information, conscience and religion; to prohibition of torture, capital punishment and life imprisonment; to segregation from adults in places of detention, etc.) to economic, social and cultural rights (such as the right to survival and development; to protection from economic and sexual exploitation; to the highest possible levels of health; to education; to an adequate standard of living; to social security; to rest, recreation and the use of his own language, etc.).

The rights of children to the free expression of their opinions on matters concerning them; to seek and receive information; to enjoy freedom of thought, conscience and religion in line with their age and maturity; to associate and hold meetings, and to have their private life represent a set of rights never before recognized as belonging to children. Although the laws of many countries do recognize some of these rights, the comprehensive set of rights provided for in the Convention is undoubtedly a novel element in international law.

Although the adoption of the final text of the Convention was achieved with the consensus of all

the country representatives, who had for ten years discussed each of its articles in detail, and although in many cases positions and aspirations which had been defended with passion and conviction were sacrificed in the interest of that consensus, we now clearly see that it is precisely the rights that could be placed in the category of rights of participation which are being questioned by traditionalist and fundamentalist sectors in both East and West, in both industrialized and developing countries. An example of this is the position taken by the delegation of the Vatican and by Moslem fundamentalist groups at the 1994 Cairo Conference on Population and Development and the preparatory discussions on the platform to be adopted at the United Nations Women's Conference (Beijing, 1995), questioning the right of adolescents to have access to health information and services, including those on family planning, thereby restricting their exercise of their right to enjoy the highest possible level of health. These groups have been insisting that in all circumstances the exercise of this right must be subject to the right and obligation of parents to give guidance to their children. It is important to note that the text of the Convention makes it clear that the responsibility of parents is not to give authoritarian guidance, but a form of guidance which is appropriate to and in keeping with the evolution of the faculties of their children, in this case adolescents.

It must be acknowledged that this is a field where conflicts may occur between the authority of the parents and the exercise of their rights by their children. The Convention clearly took the view that the capacity and maturity of children are not static but evolve with time, thus meaning that they should have varying degrees of freedom. At all events, it is necessary to act responsibly to establish a suitable balance between the rights of the parents—which consist much more of obligations and responsibilities—and the right of their children to participate and choose.

3. The responsibility of the signatory States

The parties bound by a human rights convention such as the Convention on the Rights of the Child are the States which have ratified it in keeping with their own constitutional and legal systems. Article 2 of that Convention makes it clear that it is the responsibility of the State to ensure the application of the rights laid down therein to all children within its

jurisdiction, without discrimination of any kind. In establishing this responsibility of the State, it thus also lays down one of the fundamental principles of the Convention: non-discrimination. To this end, States undertake to adopt all appropriate legislative, administrative and other measures to ensure the effective exercise of the rights laid down in the Convention. This obligation is a clear mandate for the State to adopt and carry out actions involving the study of the prevailing legislation and proposals for its adaptation to the principles of the Convention, together with the execution of administrative, economic, financial and fiscal actions and measures to guarantee the effective exercise of the rights in question.

With regard to economic, social and cultural rights, article 4 of the Convention states that States shall undertake the foregoing measures to the maximum extent of their available resources. Some have seen this as an inclination of the drafters of the Convention to use the language of the International Covenant on Economic, Social and Cultural Rights, in the sense that these rights should be fulfilled in a gradual manner, as required and as a function of the availability of resources. The immediate satisfaction of civil rights would be an obligation if it did not involve any cost and would not affect anyone's wealth or interests. The enjoyment of economic, social and cultural rights—also referred to as positive rights—, however, undoubtedly raises the need for the State to make transfers to cover the cost of the services to which the population is entitled, and this would affect the property, income and general wealth of many people through various administrative and fiscal means.

When the Convention speaks of the maximum extent of the available resources, it does not mean surplus resources, as some circles have assumed, but rather the existing resources as a whole, in respect of whose use and allocation the State must establish orders of priority and importance in order to fulfill the duties it assumed when it ratified the Convention. The State will always be responsible, and the article must not be interpreted as a kind of loophole clause that would allow the State to evade its obligations by claiming that resources are limited or non-existent. The State's responsibility of guaranteeing those rights cannot be side-stepped or delegated.

This is why in the 1980s, although the Convention had not yet been adopted but on the basis of the

principles set forth in the International Covenant on Economic, Social and Cultural Rights, UNICEF called for "adjustment with a human face" that would make it possible to set up defence systems and compensatory mechanisms which could guarantee to the population as a whole, and especially to children, the enjoyment of their basic economic and social rights in the face of the non-deliberate but none the less perverse aggression represented by the macroeconomic measures being taken and the structural adjustment of the economy. Several years later, the serious deterioration noted in some countries in such sensitive indicators as infant mortality, low weight at birth, malnutrition among pre-school and school children, iron deficiencies, etc., showed that "in order to balance their economies, some States were unbalancing human lives", adversely affecting the satisfaction of the basic needs of children which were moral rights although they were not yet formally considered as such (UNDP, 1995).

Popular discontent and social protests are now connected much more with the non-enjoyment of basic economic, social and cultural rights than with the deprivation of civil and political rights. The full enjoyment of the fundamental human guarantees—civil and political rights—depends to a large extent on the satisfaction of the other human rights, to such a point that the non-enjoyment of the latter may at a given moment endanger the exercise of the basic freedoms, social and political stability, and even the democratic system itself.

4. Developments between 1990 and 1995

Most of the countries in the world have now ratified the Convention on the Rights of the Child.³ The real challenge has been and still is how to progress from massive ratification to massive implementation. Skeptics note that in many countries which have ratified the Convention, the life of children remains unchanged and situations such as the economic exploitation of children in work or prostitution still persist; children continue to fall sick and die from perfectly preventable diseases; malnutrition saps their physical and mental potential, and school attendance is either a far-off, inaccessible dream or a transitory stage through which they once passed with little or nothing to show for it.

³ As of September 1995, 179 States had ratified the Convention on the Rights of the Child.

All this is quite true, but it would be wrong to conclude that the fault lies in the instrument rather than in those who have the obligation and responsibility to put it into effect. Recognition of the equality of children with other human beings, their dignity and their legal rights is only a recent development. In the past, the silent death of children from avoidable causes was always seen as the result of fate. Seeking to control those causes, using the resources of modern technology, has been a long-standing concern, but it only became a matter of urgency after the crusade to improve children's survival undertaken by James Grant. Exploitation of child labour, the elimination of female babies and the exclusion of children from the benefits of health and education have for many, many years been accepted as expressions of traditions and local cultures. There will always be some tension between the aspirations for universal respect for human rights and the position of those who resist universal rules of behaviour—based on the idea that human nature is the same the world over—which can surmount deep-rooted beliefs and ancient traditions and practices.

It is also true, however, that many nations have indeed reacted to the discrimination, exclusion and infamous criminal practices committed against children (and especially girls), although regrettably such abuses continue. There is now a greater awareness of these problems, like that which existed just before the abolition of slavery and the eradication of apartheid. The awareness that a child is a human being who is entitled to his rights and represents the future of society is gradually gaining weight. The application of the principle of the "best interests of the child"—another of the great pillars of the Convention—has sufficient potential to be invoked against all practices which are incompatible with the human rights of children.

Ratification of the Convention expresses the State's determination to respect, defend, promote and ensure the application of the rights of the child. Regardless of the international pressure exerted by various forums (the World Summit for Children, the World Conference on Human Rights, etc.), ratification is a sovereign act of the country in question; no-one can oblige it to sign, but everyone has the right to call on it to fulfill its obligations. No State can evade its fulfillment by adducing "international pressures". Ratification of the Convention represents the starting point: the beginning of a process which

will have important consequences for the ratifying State and especially for its government and public authorities.

The first of these consequences is the open acceptance of responsibility for the Convention's implementation. From the moment of ratification, a watch begins to be kept on all the signatory State's movements and actions to guarantee children's rights within its country, by its own citizens, by political groups and non-governmental organizations, and by communications media with great power to influence national public opinion. The extent of this work of vigilance and supervision varies from country to country and will depend on the maturity and level of development of the citizens and non-governmental organizations and on the degree of political freedom and freedom to openly express judgements on the way the State is implementing the Convention.

The second consequence is similar to the first, but takes place at the international level. One of the obligations assumed by a State which is a party to the Convention is to present a report to the Committee on the Rights of the Child, through the United Nations Secretary-General, two years after the date of ratification. This report must give details of the measures that the State has taken to ensure the effective and progressive fulfillment of the rights laid down in the Convention.

The effectiveness of such reports depends largely on the truthfulness and clarity of the information given and on the Committee's capacity to obtain data and indications on the application of the Convention from other sources (United Nations bodies and other competent organizations, among which the drafters wished to include non-governmental organizations, although they did not mention them expressly).

Since 1993 up to the present, the Committee on the Rights of the Child has studied 38 country reports.⁴ Some of them have reflected the age-old tendency to be rather flattering about their own actions but not very clear or informative about the real situation of children and the status of their rights. On various occasions the Committee has asked the State whose report is under consideration, in public session

and in the presence of that State's representatives, to provide fuller information or even, in some cases, to submit a new report that really answers the Committee's questions. The time limit given for the submission of such a new report is normally quite short.

This is a new practice which has not been usual in bodies responsible for following up compliance with covenants or conventions on human rights.

It is well known that the international machinery for following up and checking the application of such instruments has been and continues to be the weakest aspect of the whole question of human rights; consequently, the example being established by the Committee on the Rights of the Child is very important not only for the effective supervision of children's rights but also, in general, for the observance and effective exercise of human rights laid down in other instruments. As the Convention was the last of the great human rights instruments to be adopted, its drafters took the fullest account of the experience of other pacts and conventions whose follow-up bodies have extremely limited capacity for action.

Possibly one of the most important consequences of the ratification of a human rights instrument is the fact that it submits the State to the scrutiny of international public opinion, not only of the Press but also of many non-governmental organizations which keep a very close and efficient watch on the observance of the rights in question. There are no countries in the world of today, whatever their size, power or resources, which can afford to completely ignore international opinion on the human rights situation in their territory or which can avoid being affected in terms of their image, credibility and internal and external political and economic relations when world public opinion brands them as countries where human rights are violated. The drafters of the Convention, fully aware of the importance of the verdict of public opinion, laid down in their text the obligation for the signatory State to give wide circulation to the reports presented by it and the final conclusions or observations adopted by the Committee after their study and discussion.

Although the machinery for public denunciation and criticism has indeed been important and effective in inducing States to initiate and implement actions to correct violations of human rights, the United Nations system must nevertheless review and define mechanisms to make possible more comminatory action whereby States are forced to take action to solve

⁴ As of September 1995, sixty States had submitted their reports to the Committee on the Rights of the Child, while 87 States Parties are behind with the submission of their reports.

situations of violation of human rights, publicly announcing the actions they propose to take for this purpose, and whereby they are prevented from taking shelter behind outmoded concepts of sovereignty. This matter was dealt with very fully by the United Nations Secretary-General, Boutros Boutros-Ghali, in his address to the World Conference on Human Rights in Vienna, in which he said that there should be provision for international intervention when States prove to be incapable of guaranteeing human rights, when they violate the fundamental principles of the United Nations Charter, and when instead of protecting the individual they become his oppressor (United Nations, 1993).

Many States all over the world which have ratified the Convention have taken very significant steps to put its principles into effect or at least gradually come closer to satisfying the rights of the largest possible number of children. The experience of the past few years has shown how substantial the process of the adaptation of national legislation has been. In many countries, the absence of relevant laws or the existence of laws which ran counter to the principles of the Convention did not permit their effective observance or application by the competent bodies. This has made it necessary to set up working groups to revise and adapt the legislation, with the broad participation of various sectors of society. A matter of special interest has been the review of national legislation on civil rights with the aim of eliminating provisions which still discriminate among children on the basis of the type of union existing between their parents when they were born and of correcting the law as it applies to young people, in order to give minors proper administrative and judicial guarantees. In view of the great importance of this task, it would be a mistake if the State felt that it had done its duty as soon as it had placed the duly considered reform projects in the hands of the competent authorities, parliaments, congresses or legislative assemblies.

In Latin America and the Caribbean, almost all the countries have embarked with great enthusiasm and celerity on the review of the existing legislation in order to bring it in line with the principles of the Convention. In various countries it has been necessary to propose new legal texts or even to codify the highly dispersed laws already existing in the legislation.

Indonesia, for example, which entered reservations in respect of seven articles of the Convention

when it ratified it, took account of the observations made by the Committee when it considered its report, and it has announced that it will withdraw four of those reservations in areas where the State could be taken to have given priority to domestic rules reflecting the prevailing traditions and cultural values. This action is highly significant, and if confirmed it would reflect the considerable weight that many countries have given to this instrument, to the recommendations of the Committee on the Rights of the Child, and to the priority that needs to be given to the principles expressing the human rights of children.

Another important consequence of the implementation of the Convention has been the establishment of new structures and mechanisms at the national level for watching over the application of the rules on children's rights and identifying cases of lack of respect or outright violation of those rights. Some countries have bodies which are independent of the government, such as the Citizens' Defender in Costa Rica, or the Defender of the People in Colombia, and the competence of these bodies has been widened to include supervision of respect for children's rights. In other countries, such as Austria, offices of the Federal Defender of Children and Young People have been set up in all ten provinces.

5. Poverty and human rights

Poverty is the greatest enemy of human rights. Thus, the Declaration of the World Conference on Human Rights (Vienna, 1993) states that extreme poverty and social exclusion are violations of human dignity and that generalized extreme poverty inhibits the full and effective exercise of human rights (United Nations, 1993, paragraphs 14 and 25).

The Declaration of the World Summit for Social Development (Copenhagen, 1995), for its part, establishes a commitment to provide a legal framework which includes and promotes full respect for all human rights and fundamental freedoms (United Nations, 1995). Likewise, the first pledge of that Declaration is to reassert and promote the rights set forth in such international instruments and declarations as the Universal Declaration of Human Rights, the Covenant on Economic, Social and Cultural Rights, and the Declaration on the Right to Development, including those relating to education, nutrition, housing, employment, health and information, in order to help in particular those living in poverty, to which

end the signatories pledge to fight for those rights (United Nations, 1995).

Mankind's hope today is that the economic and social marginalization of the growing number of people who are affected by poverty and silently excluded from the exercise of their basic rights will indeed be seen as a serious violation of human rights. Those most seriously affected by this process of exclusion are of course the poor, but especially children, and through them society itself, which thus suffers the diminution of its possibilities of development and progress. This is why it is so important to give a leading place to children in political action to secure the timely and effective satisfaction of poor people's needs, which are now seen as rights. As James Grant, the recently deceased Executive Director of UNICEF pointed out, a boy or girl has only one chance to develop normally, and the protection of that one chance therefore calls for a commitment which must never be overtaken by other priorities:

there will always be something more urgent, but there will never be anything more important (Grant, 1995).

James Grant's words are a call to reflection for all of us and very specially to the leaders of Latin America and the Caribbean, where 200 million people live in poverty, most of them children and young people. In this region where, in the words of Carlos Fuentes, "our efforts to generate wealth have constantly been impaired by our inability to achieve equality" (Fuentes, 1995), the eradication of poverty is an endeavour which should take on the same characteristics as the struggles to abolish slavery, colonialism or racial or sexual discrimination. Keeping a people, including its children, in a situation where its basic needs are not satisfied is also a form of discrimination, a violation of human rights, and just as ethically unacceptable as any of the other types of discrimination (Albáñez, 1993).

(Original: Spanish)

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Governance, *competitiveness* and social integration

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This article seeks to set forth the grounds for an approach integrating political governance, economic competitiveness and social integration as interdependent variables. To this end, it looks at the possibilities for Latin American society to simultaneously increase its capacity for democratic self-government, improve its economic competitiveness and tackle the main problems of social exclusion and poverty, since if this is not done the region will find it more difficult to take its place in the concert of modern democratic nations. In order to analyse the evolution of those variables from a systemic standpoint, each of them is first of all reviewed separately and then an attempt is made to construct an interactive scheme for their mutual relations, bearing in mind the economic and cultural conditions for productivity growth and the need for a social and political matrix which will give a sense of direction to the overall set of variables. This analysis reveals the emergence of a new logic of conflict, which is no longer between the State and the various social and political actors but concerns the cultural direction of governance, competitiveness and social integration; the question is no longer the need for the simultaneous presence of the factors of development but their possible political and cultural directions and leanings. It is concluded that guiding this new type of conflict in the right direction calls both for a prior consensus on some meta-values which will allow the parties to negotiate and deal with arguments using a common language, and for political reforms which include a clear and effective system of sanctions for those parties who do not respect the agreed terms.

I

An experimental hypothesis

Within its multiplicity of individual experiences, Latin America now seems to be living through the end of a period of economic adjustment whose results are rather uncertain, since no-one can be sure that the anti-inflationary policies and fiscal adjustment processes which have been implemented are a real guarantee of economic retooling, social equity and consolidation of democracy.

On the contrary, although substantial advances have been made in terms of economic stability and even export levels, the results on the social and political levels leave much to be desired, since the inflation and adjustment processes have meant greater social inequity and high political costs for the building of democracy.

In order to analyse these processes, it seems appropriate to seek an approach which integrates them and makes them interdependent, since a purely economic, political or sociological approach entails severe limitations for understanding the situation being experienced and even more so for proposing options to suit the new period that the region will have to live through. With regard to special considerations concerning the disciplines involved, an effort will be made here to carry out a conceptual analysis of the three interdependent variables in question which are important for understanding Latin American development: governance, competitiveness and social integration.

In order to extract the most positive elements from the individual national experiences, it is important to be familiar with the different limit situations that the countries of the region have experienced and are still experiencing: for example, the perverse political and economic effects suffered by Venezuela as a result of the failure of its social policies, the combi-

nation of complex economic factors which have affected the economic stability of Mexico and aggravated the processes of social and political exclusion, or even the risk that, in Chile, the country's economic advances may be adversely affected by the ethical and political conflicts which have not yet been solved by the Chilean transition process. It is within this framework, then, that the following conceptual reflections are put forward on the basis of the Bolivian experience.

Is it possible that, in the light of the current political, economic and social tendencies, Latin American society can increase its capacity for democratic self-government, substantially raise its economic competitiveness, and really tackle the main problems of social exclusion and poverty? Or will Latin American societies continue to fulfill the "Sisyphean" prophecy that prevented Bolívar from sleeping in his moments of doubt and anguish?

Various national and regional studies show that progress has been made in some aspects of political governance, some modest advances have been achieved in competitiveness, but almost nothing has been attained as regards aspects of social integration connected with the substantive improvement of some basic social development indicators and above all as regards the creation of a system of autonomous social actors capable of negotiating and influencing the dynamics of competitiveness and democratization. If this situation continues, Latin America will not be able to take its place in the modern world.

According to the hypothesis followed in this analysis, in order to understand the evolution of these variables it is not enough to apply some kind of particularist rationale: it is essential to apply a synergic and systemic logic in the analysis of their interactions. This does not mean that everything has to be done all at once: on the contrary, the systemic approach assumes the existence of a strategy, with stages, processes, limits and critical appraisals. Any action in any of these areas tends to affect the others positively, negatively or ambiguously, so that the strategy also entails calculations, risks and decisions.

□ This article is part of a study on governance, competitiveness and social integration in Bolivia which is currently being carried out by CERES-CEDLA as part of a regional-level comparative study on "Strategies for governance in the crisis" sponsored by the CLACSO-UNDP-UNESCO programme. The author wishes to thank Gerardo Berthin and Antonio Vigilante for their valuable comments.

In this article, a conceptual analysis is made of governance, competitiveness and social integration, after which an attempt is made to construct a kind of "interactive model" by seeking the possible

relations among these variables, arriving at the conclusion that a new logic of conflict has emerged and that political reforms are therefore called for in the region.

II

Politics and governance

Present-day societies are faced with a kind of hyper-acceleration of political time. In these circumstances, a political approach is called for which reduces uncertainty and seeks to achieve the desirable as a function of the possible, but on the basis of values which permit fruitful links between democracy, the restructuring of the economy, and social integration.

It is therefore of fundamental importance to arrive at a new approach to the possible, bearing in mind the possibilities for the structuring, formulation and synchronization in time of the political elements involved. The quest for the best possible results at all levels of economic and social life is a task involving political time. It includes, for example, the need to surmount the heavy burden of Latin American political culture, which confuses what is urgent with what is necessary and mingles the short term with an infinite future.

From this point of view, politics could be understood as a system of relations which should seek to reduce uncertainty and mediate between opposing interests through a suitably implemented democratic system of decision-making and authority. Naturally, these are values built up in opposition to the new consumerist and impersonal technocratic power, especially in the midst of the tendencies towards crisis being displayed by the systems of political representation and action. In this connection, in order for "government through politics" to be effective and legitimate, the different areas and levels of society must be aware of their options and of the consequences of given political, economic or social actions, and above all they must be able to decide whether those consequences are desirable or not. In this respect, we have assumed that the quest for the socialization and transparency of politics will not only bring elements of rationality and critical analysis into politics, the economy and society, but will also strengthen the social and ethical responsibility of politics.

The question of governance is at the very heart of these dynamics. It is not only a resource for reducing the harsh tendencies of uncertainty, but also an impulse to think, invent, reflect and discover what is possible, probable and preferable; it is a force in politics which works with realism but which not only demands the capacity to adapt to reality but also needs to be borne in mind with a view to changing that reality to bring it closer to the values of freedom and equity.

In this sense, governance is connected with the political capacity of a society and must be seen as a political construct: a construct which involves a set of actions associated with the formation of a system of political relations involving power, leadership and authority. The root of the question lies in the way the actors stand with respect to the political system. While governance in general concerns the construction of an order, however, democratic governance concerns the construction of a pluralistic, conflictive and open institutional order.

The concept of governance is not a theoretically developed concept but has been used rather to describe very specific situations and circumstances. In United States political science, governance has been used mainly in its restricted sense of quality of government management. Originally, just after the war, the concept was associated with the idea of economic instability.¹

Crozier, Huntington and Watanaki (1975) later developed the concept in relation to political crisis. For them, political participation has given rise to a disaggregation of interests and an excess of demands which the political system is not capable of process-

¹ See Denis (undated), for example. In his well-known *Diccionario de ciencia política*, Norberto Bobbio (1987) understands governance as the result of negotiations among liberals and democrats.

ing; in this sense, governance would be the capacity to process such conflicts. However, these authors do not analyse whether this expansion of conflicts that cannot be processed is the result of the expansion of capitalist development itself.

From the standpoint of critical sociology, Claus Offe (1982) sees governance as a limit of the capitalist dynamic with regard to social integration: accumulation processes which are not subject to any political regulation lead to ungovernability, and he considers that in capitalist regimes there is an inertial tendency towards such a situation.

In Latin America, the concept of governance has a less elaborate and varied background, and it is very often confused with the idea of political stability. There has been some progress in this respect, however. For example, a project of the Latin American Council for the Social Sciences (CLACSO) on governance strategies in the crisis contrasts governance with ungovernability, which could arise, on the one hand, as a result of the erratic behaviour of entrepreneurial economic actors who may "break" the minimum levels of functioning of the economy or of what has been called systemic governance, or on the other hand as a result of greater social disintegration and exclusion in lower-class urban sectors. More recently, Mario Dos Santos and Marcela Natalicchio (1993) have clarified a certain rather ambiguous view of governance, asserting that "Governance means a good performance by the government in terms of sensitivity to demands, efficient administration and management, and also transparency and accountability, or responsibility to society for the actions of the government. In contrast, governability is a situation of complex systems involving the self-reproduction of the system".

Taking an approach which focuses more on development issues, in its human development reports UNDP holds that a necessary condition for such development is a political pact or commitment directly associated with greater decentralized popular participation. In a recent report on governance in Latin America, a group of analysts sponsored by that institution assert that "democratic governance requires the patient and progressive building of certain minimum agreements; efforts to secure greater convergence of interests, and creativeness in order to make elements that divide subordinate to those that bring greater unity. In short, it depends on proper organiza-

tion of politics and participation" (UNDP, 1993 and 1994b).

The World Bank has also furthered this debate: for example, Edgardo Boeninger has linked governance with the capacity of governments to exercise authority, settle problems and implement policies, which would also imply the strengthening of public and private institutions (World Bank, 1991). Angel Flisfisch (1989), taking a more theoretical view, has related governance to a new type of approach to the dynamics of economic development, the latter being strongly influenced by Albert Hirschman's "strategy of sailing into the wind". Some political studies have also been carried out in the region which link electoral matters with governance (Trinidad, 1991).

In Bolivia, René Mayorga (1992) has compiled a text on governance which focuses on the problems of democratic regimes.² The Office of the Vice-President of the Republic, with the collaboration of UNDP, has prepared a governance programme centering both on aspects of good government and on governance proper. This is perhaps one of the most novel projects for the modernization and legitimation of the State that has been embarked upon in the region.

As we recognize the importance of the conceptualization of governance and the advances and problems that this involves, we maintain here that the notion of governance is associated with a certain minimum capacity of effective and efficient management and authority that the Executive must have *vis-à-vis* the other powers in the State and society as a whole. In a broader sense, governance also implies the democratic nature of the government, because of the need to attain a certain consensus among the members of society in policy formulation and the settlement of problems, with a view to making significant advances in economic development and social integration: in essence, what is involved is raising the quality of government by increasing the self-government capacity of society itself.

² More recently, as a result of various of these efforts, an interesting and controversial compilation has been published, entitled *Buen gobierno para el desarrollo humano* (Toranzo, 1994).

III

Entrepreneurial ethos and competitiveness

The type of competitiveness we have in mind here is, in principle, what Fernando Fajnzylber (1983) called "genuine competitiveness". According to this author, in order to achieve such competitiveness it is essential to strengthen the domestic capacity for industrial creation, in conjunction with growing joint participation by the agents of production and of knowledge: in short, it would mean creating an endogenous nucleus of technological growth. ECLAC subsequently further developed and deepened these concepts (ECLAC, 1990; 1992a and b; 1994a and b). This approach to competitiveness has a shortcoming, however: it does not include the analysis of the State, political and historical elements affecting governance and consensus, or of the cultural dynamics. In reality, the idea of conflict and communication among the actors and that of the entrepreneurial ethos, which are decisive aspects as regards competitiveness and the building of an endogenous nucleus of development, are either totally absent from the new ECLAC thinking, or are dealt with to an extent which has so far been very limited.

In Latin America there is a kind of self-centered culture which leads to lack of understanding and absence of communication among the various social actors, as well as to a marked lack of differentiation of roles, typical of corporative patrimonial systems which have historically limited the possibility of developing an expansionary entrepreneurial ethos and genuine competitiveness. Historically, the logic of social conflict has itself been distorted and reduced to a conflict between the State and the workers, rather than being a system of varied and complex social relations and collective actions (Calderón and Dos Santos, 1995).

As ECLAC has noted, what is needed is to achieve a form of economic growth based on an endogenous logic which promotes the incorporation of technology and the renewable use of human resources, rather than abuse of the labour force and the indiscriminate exploitation of natural resources. If we go beyond a strictly economic logic, however, competitiveness also depends on business management capacity, both for the modern, rational functioning of

firms at the national level and for the development of globalization strategies at the international level.³

Michael Porter (1991, p. 543 *et seq.*), taking a functionalist view from the standpoint of the enterprise, has described competitiveness as a dynamic process in which innovation is a significant constant for the development of new products, new kinds of markets and new production processes. This also means the combination of a number of subsystems connected with national forces and objectives, government instruments, competitive environments, strategic decisions, constant learning, and above all national production and support capacity. It also ultimately means looking for competitive advantages. Such competitive advantages require a set of conditions that will allow a nation to develop on the basis of its factors of production, through joint positive motivations in worker-employer relations, domestic competition, improvements in the quality of demand, and training for the establishment of new enterprises. Ultimately, in Porter's approach, competitiveness seems to depend on the quality of the socio-entrepreneurial behaviour of a society. Perhaps the most substantive criticism that can be made of such a view is the evolutionist and teleological nature typical of this kind of thinking, which sees the conflict and historical factors merely as anomalies.

At all events, what is involved here is the need to adopt a broader logic in which the fundamental question is not to find out whether the economy operates on the basis of a State or a private-sector logic, but rather to find out if there is an entrepreneurial dynamic which covers the whole of society: that is to

³ Recent research seems to show the importance of a certain positive research and development (R&D) relationship between the industrialized nations and the developing countries. "The results suggest that the total factor productivity of a developing country is a function of the total R&D capital of its trading partners (which is used as a substitute for the amount of knowledge incorporated in the country's trade structure), the openness of its foreign trade with industrialized countries, and the level of training of its labour force" (IMF, 1995, p. 55). In this respect, it would appear to be important to explore the amount of marginal benefit that could be produced in an endogenous nucleus through the effects of foreign R&D.

say, if there is a system of relations among the various actors and institutions which, on the basis of rational arguments and actions and with the risks and flexibility characteristic of the modern world, has shared and negotiated goals. In this logic, which is equally valid for enterprises and for political parties, there cannot be true competition at the national level if modern enterprises exist side by side with traditional parties.

Fajnzylber began to make this logic more explicit when he said: "Linking up with the international economy involves far-reaching changes in institutions at many levels: within the enterprise; in the relations between employers and workers, between government and business, and between government and workers; at the regional level of government; in the political system itself, and in overall human relations. Therefore, opening up an economy to the exterior is much more than merely lowering tariffs. It means embarking on a whole new way of functioning: economically, socially and politically".⁴

It is of fundamental importance, however, to strengthen this type of thinking in a globalized logic. After many studies, Manuel Castells concludes that a new international division of labour is emerging, determined by the greater competitiveness of enterprises, in which enterprises and States, if they are not to perish, have to operate in an international horizon of markets and inputs. In this process, competitiveness (and ultimately technology, especially in the field of information) will determine the level and form of living of the population, the popularity of governments, and the governance of societies. A type of social dynamism would appear to be emerging which is based on the strategic role of knowledge, increased flexibility of the system,

and the transition from big centralized enterprises to decentralized networks made up of many different forms and sizes of organizations. These networks will be the form of organization that will prevail in the new world order. For Castells, societies will fundamentally consist of flows of information among networks of organizations and institutions. Thus, the historical process of transition towards the information society will be dominated on the one hand by the existence of a global economy and worldwide information networks, and on the other by nationalist societies, community-based cultures, and increasingly dispensable States (Castells, 1988, 1989 and 1995).

It is of fundamental importance, then, that there should be a generalized entrepreneurial ethos which reduces the consumerist, rent-seeking and featherbedding logic of Latin American entrepreneurs and of many of the societies of the region, making way for an ethos of modern responsibilities linked with the expansion of production, improvement of the quality of domestic demand, and an ongoing attitude of austerity in keeping with the social, productive and cultural characteristics of those countries. This does not mean trying to impose a form of behaviour slanted in favour of production or distribution, but rather an effort to convince all those concerned that the development of genuine competitiveness will favour both individual interests and those of society as a whole. In the final analysis, it is argued that expansion of production strongly linked with the external market can only succeed if it is based on a broad sense of national cohesion and participation. It is strange to see that, often, the poorer a country is, the more luxury-loving and consumerist its social and political elites are.

IV

Society and social integration

Social integration is one of the richest and most classical concepts in sociology. It originated at the end of the last century as a consequence of the "anomalies" or distortions produced in traditional or community society, in the absence of social control mechanisms, by the industrialization process.

Sociology began to ask questions about the conditions in which order and unity are created and reproduced in society. The various schools of sociological thought answered the questions in line with their own historical conditioning factors. For the Europeans, patterns of social integration were linked to the processes of institutionalization of conflicts and to the development of new forms of organic soli-

⁴ Cited by Lahera, Ottone and Rosales, 1995.

dustry; for United States sociologists, they were connected with the power of the political and judicial institutions and the integrative force of colonizing migrations; for the Soviet Union, they were due to the political and participative ideology of the October Revolution and the Communist Party. For the Latin Americans, they were the result—especially in the period after the war—of the articulatory and integrative role of the hacienda and the persistence of a heritage-based and client-based intra-societal pattern. Later on, populism or nationalist-populist regimes were the forms of organization of social integration.

Obviously, these various patterns of social regulation involved the action of social control agents for maintaining given forms of domination, expressed in very specific institutional and normative spaces. However, they also reproduced different forms of social relations and social links. Indeed, any form of integration implies differentiated, conflictive and socially ranked relations. At all events, in many of these patterns a sense of self-reproduction of social control prevailed.

The notion of internal conflict and its evolution was merely peripheral. Only later on did critical sociology begin to demonstrate the persistence of a crisis between the evolution of the new dynamics of production and consumption and social integration. Alain Touraine (1973, pp. 113 and 192) has stressed the idea of a change in the type of domination whereby relations would tend to cease to be based on the exploitation of labour and be based instead on the manipulation of demand, deterioration in living conditions, and monopolization of resources and decision-making power, thus changing the very logic of protest and social integration.

Conflicts due to changes in society—such as the restructuring process and the raising of competitiveness, the hyper-acceleration of political time, the consequent processes of concentration of decisions and the emergence of new types of protest (which affect Latin America too) in respect of issues in the fields of ethics, consumption, ethno-cultural problems, sex-related issues, religion, local issues, etc.—are emerging with unprecedented force in the areas of social integration, cultural reproduction and socialization. It is perhaps precisely because of this that the most significant problems of present-day society concern the quality of life.

A recent UNDP study notes that in the last five years over 70% of all conflicts developed inside na-

tional boundaries, generally producing further deterioration of everyday aspects on the various planes of social life. The study also mentions that the importance of conflicts between countries is tending to decline, and it says that the weakening of the fabric of society is a central problem for all countries of the world, rich or poor, although this weakening takes different forms and levels, depending on the type of society involved (UNDP, 1994a).

On a theoretical level, Jürgen Habermas (1973) considers that the crisis is associated with experiences of change in the structures of the systemic heritage of a society and the perception that one's identity is being threatened; in other words, that a society is in an integration crisis when the new generations no longer see themselves reflected in a normative order which previously had an organic quality. He also notes that it is important to verify the moment at which problems of self-government arise, since this is where social and systemic integration connect with each other. For Habermas, social integration refers to systems of institutions "in which speaking and acting subjects socialize; here, systems of society take on the aspect of a life-world structured through symbols", whereas systemic integration refers to specific self-government achievements in a self-regulated system (Habermas, 1973).

In the present socio-historical conditions of Latin America, the notion of social integration can be equated with a society's capacity to build active citizenship, eliminate discriminatory barriers in the market, and spread a culture of solidarity.

Citizenship, although individual, assumes a certain sense of belonging to a community through which the individual develops himself and exercises self-determination. The individual is part of a national political community in which he recreates his identity within the ambit of recognized political institutions. Citizenship is also directly associated with social equity and the right to equality of opportunity, which in the present historical circumstances implies the growing socialization of scientific and technological knowledge. In these conditions, citizenship is linked with the self-government of society and with the elective and delegative exercise of political rights in which the different classes and cultural or regional groups must necessarily act as true citizens if democracy is really to work. This assumes recognition of the rights of the "other", different from oneself, whether that "other" is an individual or a group, and

it also assumes autonomy of the actors with respect to the State.

The market reflects a social relationship which implies equal opportunities for work and production in order to make the processes of competition and social mobility functional. It is not in keeping with the persistence of mechanisms of discrimination which limit the integrative capacity of the market to build up both a suitable form of demand by society and a supply structure which is not distorted or non-competitive. The mechanisms of social mobility must be organized as a function of the capacity, efforts and equality of opportunity to compete on the markets, and there must be open channels of social mobility which strengthen integration. Citizens are also consumers.

The culture of solidarity is linked with the quality of the social fabric of a given community, with the mutual links among its members, and with the capacity to tackle common problems and goals. In cases like that of Bolivia, the roles played by diversified family structures, communities and small-scale entrepreneurial units are important examples of solidarity. The culture of solidarity links private and public interests and refers to the capacity of society to reconcile genuine competitiveness with progressive governance. Such a link means the achievement of a "common good" in a society. In this process, the question of poverty is not just something involving a historical social category but is the result of exclusive social relations. Many national and international reports tend to deprive poverty of both its ethical and its sociological dimension, turning it into a mere item of the statistical landscape, without any feelings being involved. From the standpoint of social integration, the poverty problem is above all a judgement to be passed on social relations.

In Latin American politics there is a strong tradition of class and rank which is reflected in a pattern of socialization that makes it more difficult to build up a principle of equity which gives to the "other" different from "oneself" the status of a subject with valid interests and legitimate rights. Spurious compe-

titiveness is intimately associated with this tradition. In reality, it is a subconscious societal outlook which sees poverty as a mark of inferiority and deprecates the exercise of individual rights. For this political tradition, the poor is not a regular citizen but a figure full of inferior attributes, needy and vulnerable, who should be taken care of by private philanthropy, State tutelage or international cooperation.

The most generalized conception of poverty is closely linked to the way in which rights are denied at the level of social relations, and the possibility of overcoming poverty is linked on the one hand to the capacity of society and of the poor themselves to turn their needs into demands that can interact within the political system, and on the other to the expansion of the culture of solidarity.

In this sense, winning citizenship is a vital step towards social integration. It involves policies and societal actions that gradually change the social situation and, above all, public treatment of the problem and its linkage with the issue of equity and development. All this depends largely on the construction within the area of social interests of public spaces in which the problem is legitimated through free debate on what is just or unjust, as part of the democratic practice of ongoing negotiation.

Social integration aims to achieve certain minimum threshold levels of reproduction of the population –the United Nations human development indicators, for example– and to secure the elimination in both legal and real terms of a number of barriers and discrimination mechanisms –by sex, age, race, etc.– in the market, in society, and in public and private institutions. Likewise, in a broader sense, social integration involves a matrix of social actors who mutually interact, using rational and value-based arguments, to reach consensus on objectives of integration, competitiveness and governance. In such a logic, the ends cannot be separated from the means.

In this context, one basic conclusion is clear: unless social trends are reversed, the cost will be very high in terms both of governance and of competitiveness and development.

V

The development triangle, with its surrounding rectangle and its central point

When we look at the synergic and systemic relations between the concepts of governance, competitiveness and social integration, it seems inconceivable that they should operate independently of each other, since they mutually strengthen each other and interact synergically in a positive or negative direction.

Thus, for example, attaining an optimum level of governance will only be possible if at the same time measures are taken to nurture and condition a form of economic growth based on genuine competitiveness and if all this is based on a solid consensus built up by social actors who jointly seek to raise the quality of life of the population. In the same sense, competitiveness will only be sustainable if the quality of society is strengthened in terms of both education and expansion of consumption markets; in this respect, social integration is itself a productive force.

Finally, social integration will not be soundly based unless it is associated with effective, coherent

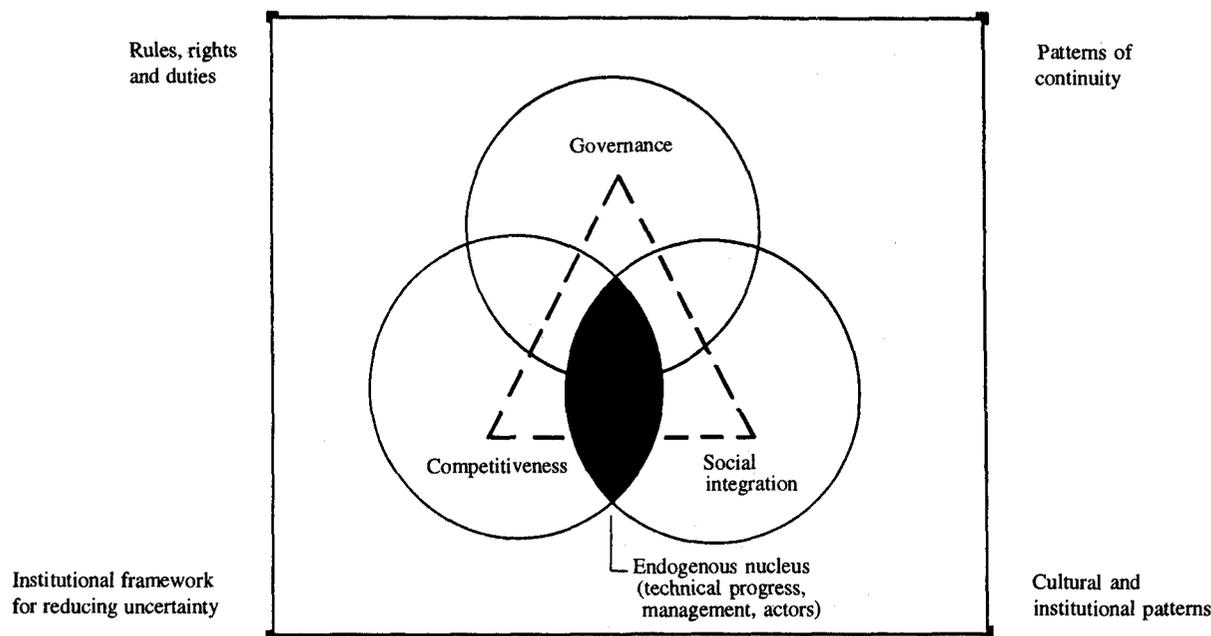
and legitimate government policies and with sustained growth of the economy. All this means heightening a capacity for action in keeping with the evolution of the respective circumstances.

Although this triangle—governance, competitiveness and social integration—is of fundamental importance for attaining some endogenous development capacity (figure 1), however, that capacity will be insufficient and anomalous unless it forms part of an institutional framework which guides the changes and policies under way in the right direction; in the figure in question this is represented by a rectangle which indicates at its vertices, within a context of systemic logic, the functions and characteristics of that framework.

It may be assumed that an institutional framework not only sets out the consensual rules of the game but is also adapted to the historical characteristics of the process of change currently being undergone by the region

FIGURE 1

Triangle of development (governance, competitiveness and social integration), with its outer rectangle and centre point



as part of a worldwide process of economic globalization and hyper-acceleration of political time.

The first vertex of the rectangle which represents the institutional framework in the figure corresponds to a set of clear rules, rights and duties regarding competitiveness, governance and social integration. Entrepreneurs, for example, must internalize the institutional frameworks in the light of the possible means and real advantages that will allow them to invest and develop, but they must adapt those rules to corresponding rules for the labour sector which link wage demands with demands for training and increased production.

The second vertex refers to the establishment of patterns of continuity of the institutional framework, so that there may be a kind of institutional sustainability which guarantees to the actors that their investments or political and social actions will likewise have continuity in time.

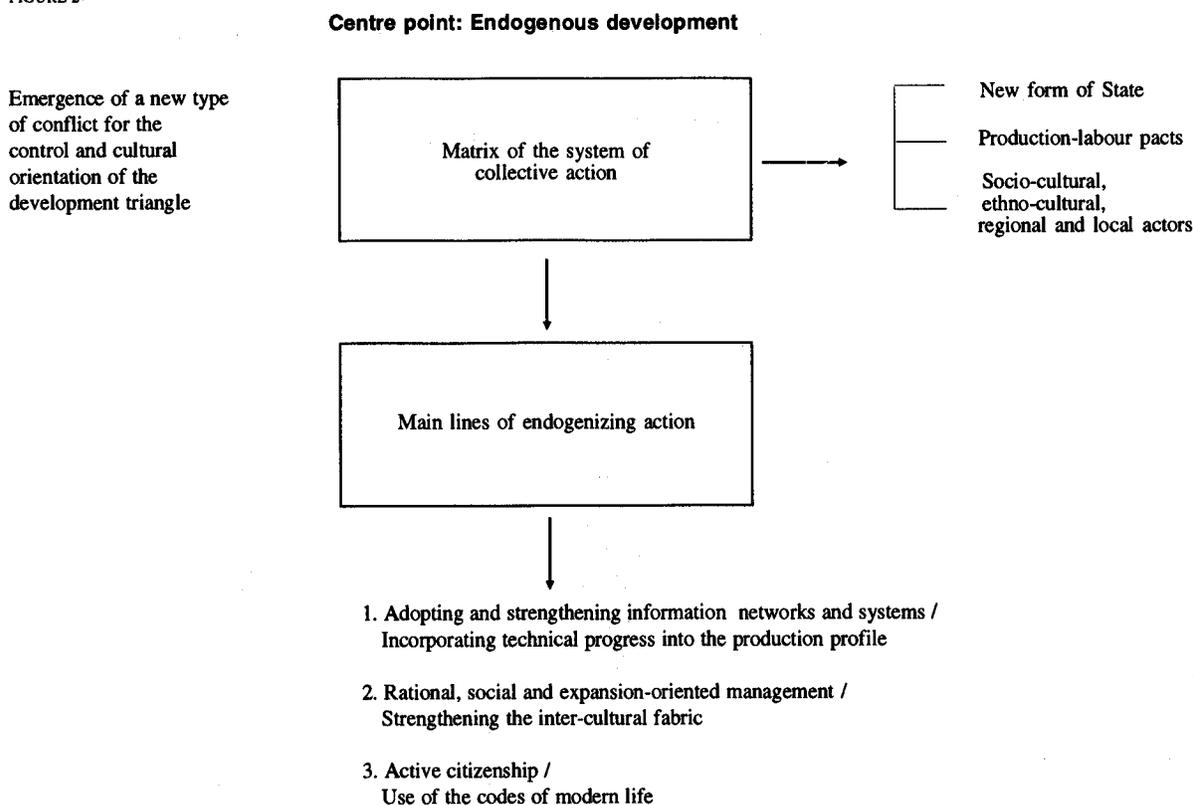
The third vertex corresponds to the establishment of a legitimate institutional framework which seeks to reduce the uncertainty produced by the anomic and inconsistent behaviour of a considerable proportion of the business, political and institutional actors in Latin American societies.

Finally, the fourth vertex refers to the establishment of cultural and institutional patterns for processing conflicts among the various actors and social groups so as gradually to get away from the patrimonial and sinecure-ridden culture that often prevails in both the economy and in politics. In the final analysis, what is involved is the building of political plurality in democracy.

It should be noted that the institutional framework described above is not closed and static, but is continually developing, changing and adapting in line with the internal or external characteristics of the development process, as a function of the formation or expansion of a self-determined development nucleus linked mainly with the establishment and evolution of the country's own domestic capacity. In other words, it involves a number of factors of productivity and governance, but above all a matrix of social actors who share a strategy to further the role of production in the restructuring of the international economy and culture on the basis of the institutional sustainability of the development triangle.

Figure 2 shows a possible and desirable paradigm integrating the triangle of progressive govern-

FIGURE 2



ance –which means governance having a synergic relation with economic competitiveness and social integration– and the rectangle of the institutionality which makes that triangle viable in normative terms.

The centre point indicates both a number of economic and cultural conditions for productivity growth and the requirements of an intra-societal and political matrix which guides the nucleus as a whole.

VI

Towards a new logic of conflict

The foregoing proposal naturally involves a logic of conflict different from that prevailing in the cycle of the patrimonial-corporative State. In that cycle, the central elements were the conflicts between the State and the various social and political actors; the desire for greater State power or for the redefinition of the relations between the State and society were the main goals of the respective actors. Thus, the para-State nature of collective action –whether by workers, employers, peasants or regional groups– and the patron-client nature of relations between the State and society automatically led to a system with weak social actors.

According to this proposal, conflict means a dispute among the various actors over the cultural direction of governance, competitiveness and social integration. What is in doubt here is not the unavoidable simultaneity of the factors of development, but their possible political and cultural trends and emphases. It is also assumed that this same logic of change would be accompanied by the redefinition of the political forces of the Left and the Right. The Left might perhaps reaffirm its actions from the standpoint of the vertices of social integration and governance, while the Right would do the same from the standpoint of competitiveness and governance.

There is no magic formula, however, for processing conflicts and moving from one situation to another, especially at times of strong social change. It is of fundamental importance, then, that as conflicts arise they should be clearly stated, acknowledged and processed in a collective manner through negotiation.

For this purpose, it is important to have real channels for the active participation and representation of the various actors, so that when debating

and settling conflicts all the interests, actors and arguments involved are taken into account. This naturally means that the various forms of public spaces must be extended in order to ensure this participation by the whole of society in the settlement of conflicts. In the case of the poorest and most under-privileged sectors, it is essential that they themselves should put forward their needs in the form of institutionally expressed demands: i.e., that they should become autonomous social actors.

Likewise, the various actors should enter into the negotiations with the full awareness that all negotiations reflect the will of the parties to respect agreements and cause them to be respected, and that this involves some mutual concessions regarding the original positions of each actor.

Finally, it is of decisive importance –especially in order to progress from one type of conflict to the other– that there should be prior consensus on some meta-values which will allow the parties to negotiate and exchange arguments in a common language: in this case, meta-values connected with the triangle of governance, competitiveness and social integration. It is also equally important, however, that there should be a clear and effective system of punishments for parties who do not respect the agreed terms.⁵

(Original: Spanish)

⁵ For a detailed analysis of political reform and economic restructuring in Latin America, see Calderón and Dos Santos, 1995.

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Port privatization, *labour reform* and social equity

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Governments of the ECLAC region have promulgated labour regimes which support port workers' desire for stable wages and job security, isolate them from market signals and create cargo-handling monopolies. The advent of a global economy, the introduction of export-led growth policies, the acquisition of advanced cargo-handling equipment and electronic information systems, and the participation of private interests in the offer of port services permit enterprises to compare, purchase and employ raw materials, labour and service inputs worldwide, and have transformed the traditional concept of competition between comparable finished goods into input-to-final product competition. Port labour is only one of the inputs in the distribution process and must be organized on a commercial basis in order to make possible competition with other ports in the world. The free play of market mechanisms offers an external standard to control the size of the workforce, harmonize the desires of dockworkers and maritime employers, and compel each to progressively improve productivity, reduce costs, innovate and make needed investments. Reforms of port labour regimes should remove regulatory impediments to the free play of market mechanisms; decentralize and deregulate the labour market; utilize antimonopoly laws which are applicable to maritime employers and labour unions to avoid misuse of market mechanisms; eliminate direct government participation in port operations, collective negotiations and informal dispute resolution, and promote opportunity-oriented social equity in the award of worker benefits. With a commercial port labour regime, maritime transport employers would come to recognize that their commercial objectives and the social goals of port labour are intertwined, and cannot be attained independently.

I

Background

For many centuries, the loading and discharge of vessels and the attendant storage of goods were carried out by informal, casual labourers in an extremely hazardous and insanitary setting. The only requirement for hiring such workers was strength, not skills or problem solving abilities. They needed no training, and were easily replaced if tired, unable to perform their work, unwilling to take risks, injured or sick. These conditions laid the groundwork for the centuries-held belief that port work was only for those who could not find employment elsewhere. Dockworkers reacted to the abusive nature of their employment and labour-displacing cargo-handling equipment by forming mutual assistance societies which would later become powerful union forces. These factors and the Great Depression of the 1930s led to a broadly held belief that government intervention was essential to economic stability, full employment and social equity in this field. This encouraged the adoption of paternalistic labour regimes by governments of the ECLAC region, many of which are still in force (Segura, 1993, pp. 32, 33 and 36; Edwards, 1993, p. 13; Banuri, 1990, pp. 51-61).

Paternalistic port labour regimes strongly support the social goals of dockworkers, create an unattractive investment setting for private interests, and have led governments to expand their role in ports from regulators to owners, investors, employers and administrators. These regimes were based upon a number of assumptions, such as: capital and labour are locked in an irreconcilable and destructive conflict; the services provided by cargo-handling monopolies can be just as cost-effective as those furnished by the private sector; neither governments nor port labour need respond to market signals; labour-saving technologies are socially irresponsible; only monetary incentives will induce dockworkers to make an effort to improve productivity and lower costs; the social costs of port labour reform are so high that governments cannot incorporate market mechanisms into labour regimes so as to commercially balance the interests of exporters, importers, carriers, dockworkers and maritime employers; and port labour monopolies, political alliances and gov-

ernment subsidies will not lead to grossly overstaffed, inefficient and expensive port services (Apolo, 1994, pp. 47, 57-59; Couper, 1986, p. 55).¹

Such assumptions have lost their legitimacy with the advent of a global economy, export-led growth policies and private participation in public-sector ports. No longer can capital and labour, for instance, be considered in terms of means and ends, and, therefore, in irreconcilable and destructive conflict, since they are in fact two measures of the same reality. They are both means and ends, and can only be attained in a setting subject to market mechanisms, because such mechanisms provide the only common, invariably unbiased standards by which the commercial objectives and social goals of capital and labour can be reconciled. Likewise, investments in labour-saving technologies have become socially responsible because improvements in productivity and cost-effectiveness make a port more attractive to users, generate new sources of employment in a port's hinterland and create a more secure work environment for dockworkers. The commercial objectives of exporters, importers, carriers and maritime employers, and the social goals of port labour, have become complementary and interdependent, and cannot be obtained without a joint, collaborative effort.

In a highly competitive global economy, social equity is opportunity-oriented and commercial. It no longer conforms to the paternalistic, market distorting, bureaucratic standards of yesteryear, because it does not guarantee jobs or a stated level of income, benefits and purchasing power to dockworkers

¹ As a recent example of overstaffing, in a dispute between the International Longshoremen's & Warehousemen's Union (ILWU), which represents port labour on the U.S. West Coast, and Peavey Grain Terminal over dismissal of redundant workers, the court held that

"The evidence reveals that for several years, the duties of a supercargo (a clerk who checks the cargo) were similar to those already being performed by the load master (the most experienced loader)".

Thus, the supply of port labour and its assignment often has no relation to the volumes of cargoes being handled nor to the cargo-handling equipment utilized. See Mongelluzzo, 1994, p. 8B, and Davies, 1993a, p. 5B.

(Apolo, 1994, pp. 40-41. It should, however, provide them with training and retraining programmes; new job assignments so that they may be rapidly reincorporated into the national workforce; early retirement benefits; fair compensation for the relinquishment of acquired rights and privileges, and an institutional framework which ensures that non-commercial bene-

fits and privileges given up by them will not be captured by another group in the port or trade community. The goals of opportunity-oriented social equity are to create a dynamic, skilled and well-paid port labour force, and to permit ports to function as unprotected business entities within a globally competitive environment.

II

Commercial mandates

Many port labour practices such as cargo-handling monopolies and inefficient two-shift operations were institutionalized during the paternalistic era. For nations which adopt export-led growth policies, such costs and inefficiencies have a negative impact on the prices of both exports and imports. Nowadays, dockworkers face an open commercial environment in which the cost and productivity of their services compete not only with nearby ports serving the same hinterland but also those an ocean away which handle similar goods bound for the same markets. As an illustration of this point, the distribution networks for fresh fruit from Argentina, Chile, New Zealand and South Africa to buyers in Chicago (U.S.A.) compete with each other, and if port labour costs are excessive or productivity is low for any one of them, this could result in loss of that market, even though cultivation and harvesting costs might be lower. Thus, the traditional concept of competition between comparable finished goods has been transformed into input-to-final product competition where each input and final product has its own demanding market requirements.

1. The port labour market

Labour unions have successfully dominated the ports of the ECLAC region for many decades because of the control they exercise over the supply of port labour through political measures such as registration systems, cargo-handling and storage monopolies and government subsidies. The capacity to compare the costs of everything from raw material inputs to labour, and from finished goods to land transport services, creates a powerful incentive to end the isolation of dockworkers from the competitive in-

fluence of the international labour market, and to improve productivity and lower costs: something that was inconceivable even a decade ago. Such registers, monopolies and subsidies have been obtained through political alliances between unions, port administrations and central governments, and they restrict labour supply, guarantee job security and provide many non-market benefits.

In the past, exporters, importers and carriers were cast in an unpatriotic light if they criticized or disapproved of excessive port costs and needless inefficiencies, and they therefore often assumed a passive, almost non-entrepreneurial posture. Port administrations, in their capacity as maritime employers, adopted a social view of their functions in order to avoid being viewed in the same disparaging light. In export-led economies, registers, monopolies and subsidies are nothing more than inefficiencies that must be eliminated in order to enhance the competitiveness of a nation's goods in very demanding international markets and, hence, the job security of port labour. The supply of dockworkers, as well as their wages and benefits, are best regulated by the requirements of exporters, importers and carriers, which is another way of saying that port labour should be exposed to market mechanisms.

The port labour movement has utilized its strategic position in ports to pressure governments to adopt political measures which lessen the impact of both exogenous (the competitive environment facing exporters, importers and carriers, and the transport systems available to cargo owners) and endogenous (productivity and cost-effectiveness of cargo-handling and storage services) factors on the demand for port labour. The introduction of export-led growth policies, however, makes it clear that the demand for

dockworkers' services depends on the demand for and competitiveness of the goods they handle, and governments can no longer avoid that reality by isolating them from market mechanisms.² The respective systems of port labour demand management favoured by the unions or by the employers create costly privileges and benefits, and ignore the commercial realities of competition faced by exporters, importers and carriers. Instead of measures to stabilize the demand for port workers, it might be more beneficial to stabilize their wages by withholding sufficient funds from their earnings to pay them wages during the customary periods of unemployment, and by creating special classes of seasonal workers.

2. The resolution of labour disputes

It has been calculated that the indirect costs of resolving labour disputes in court proceedings are 100 times greater than the direct costs of jury awards, settlements and attorneys' fees (Edwards, 1993, p. 193). The informal resolution of port labour disputes between the parties is eminently more acceptable and modifiable than one imposed by an arbitrator or judge (Schwieger, 1988, pp. 344-349). The resolution of disputes between port labour and maritime transport employers should begin with a review of the problem by a joint labour-management committee.³ In order to provide additional encouragement to use informal procedures, exporters, importers and carriers who can demonstrate that they were financially harmed between the time committee processes were abandoned and the final decision was rendered by a court or arbitration body should be permitted to recover damages from both parties in equal amounts. The informal resolution of labour disputes would then become a value-added component of port services, because the costs of management lockouts, labour strikes and go-slow movements would fall on the parties in dispute themselves.

² The United Nations Conference on Trade and Development (UNCTAD, 1993, p. 2) notes that

"... the demand by these (specific) markets for port services is derived from a demand for door-to-door logistics services which is itself derived from the demand for the products being transported."

³ See, for example, *Compañía Guatemalteca de Terminales a Granel*, S. A., 1988, pp. 28-30.

The right to strike was profusely utilized by port labour during the paternalistic era, when there were few alternative sources of products, few substitutes for desired products and trade interruptions were customary. However, the global economy, export-led growth policies, capital-intensive cargo-handling equipment, and private participation in public-sector ports have transformed dockworkers and maritime employers into partners in a joint venture with port users –exporters, importers and carriers– where an interruption of cargo-handling operations is harmful to everyone, and the resolution of disputes requires the best efforts, mutual confidence and good will of all to maintain a basis for ongoing collaboration (Di Benedetto, 1994, p. 1B; Cantwell, 1994, p. 7B; Davidow and Malone, 1992, p. 205; Cabot, 1986, pp. 112-127). The right to strike intensifies the keenly contested market facing entrepreneurs, as there are large numbers of potential entrants who would like to satisfy users' needs, so this right should be used in a manner which allows dockworkers to obtain the wages and benefits desired while safeguarding the commercial viability of users and maritime employers.

3. Job security

Regulations which prohibit discharging dockworkers substantially lessen their desire to accept work restructuring proposals, to comply with the service needs of users, and to utilize new technologies. To create job security for dockworkers, governments should adopt port labour regimes which utilize market mechanisms to achieve a commercial equilibrium between the social goals of port labour and the commercial objectives of maritime employers, as well as to insulate governments from political pressures of both groups. A market-oriented reform of port labour regimes entails the acceptance of private participation in port services, but it does not mean a return to employer-controlled job-by-job and day-by-day employment practices. The competitive pressures of a global economy mandate that job security provisions should also safeguard the commercial viability of employers. In an open, competitive port environment dockworkers will come to accept that job security depends on the success of users and maritime employers, not on guarantees laid down in constitutions and regulations.

Dockworkers made redundant by efforts to respond to the global economy through private-sector participation and the utilization of labour-saving technologies can be more easily reinserted into the national workforce if training courses are supported by job placement services, and if such courses are jointly paid for by maritime employers, governments and displaced workers. The payments by the latter could come from the legal settlements and compensation benefits they receive. Modern technologies have also shifted skill requirements for port labour from single-function activities to the need for multiskilled workers to

operate and maintain complex equipment which integrates a large number of different functions. Training programmes must give remaining dockworkers an insight into how greater productivity enhances the competitiveness of exports in international markets, as well as how it attracts exporters, importers and carriers and generates new job opportunities both inside and outside the port.⁴ At the Port of Tilbury (London, U. K.), for instance, dockworkers visit the premises of exporters and importers to observe how costly and inconvenient it is for them if goods are damaged, pilfered or delayed (Finney, 1993, p. 4).

III

Operational mandates

Governments and unions have much in common. Both are socio-political institutions which have an enormous impact on the commercial goals of users. With governments acting as owners and operators of ports, as employers of dock labour, and as direct participants in collective negotiations, unions have a ready ally because such negotiations are bipartite (government-labour), not tripartite (government, employers and labour). Disputes usually arise because users demand that governments (port administrations and maritime employers) compel dockworkers to accept modern technologies and institutional arrangements which enhance productivity and lower costs, while the unions demand that governments (port administrations and maritime employers) protect their wages, benefits and sources of employment. To resolve conflicts, governments (Ministries of Labour) intervene and usually decide that modern equipment will not be purchased or, if acquisition is unavoidable, that it will be utilized in a labour-intensive manner. In this context, dock labour often does not respond to global competition and export-led growth goals, and rejects users' requests to acquire modern equipment, improve productivity, lower costs and utilize flexible work demarcation.

1. Port users' requirements

In a highly competitive, market-driven commercial world, port labour unions can only impoverish them-

selves and users by ignoring users' requirements. Collective negotiations very rarely have anything to do with improving productivity and cost-effectiveness. Most commonly, governments (port administrations) yield to the demands of port labour unions and neither seek to determine nor respond to the commercial needs of users, while Ministries of Labour merely request larger subsidies from governments (Treasuries) to cover greater expenses. This cost-increasing spiral was broken with the emergence of a global economy, the introduction of export-led growth policies, the participation of private interests in public-sector ports and the utilization of advanced technologies. Dockworkers were isolated from competition because ports were viewed by governments as having a strategic role in national defence and economic security, but both ports and dockworkers are now emerging from that political equation and forming part of a global market in which users' needs are paramount.

Port users require progressive improvements in productivity and cost-effectiveness in cargo-handling and storage services to enhance the competitiveness of their goods and services in international markets. Most of these improvements come from advanced technologies and modern institutional arrangements

⁴ *Fairplay International Shipping Weekly*, 1994, p. 8. For a similar situation in the British coal industry, see *The Economist*, 1993a, pp. 39-40.

which can render certain skills and jobs superfluous. The port labour movement can no longer utilize its political alliances and threats of civil disturbances to preserve a historical demand for dockworkers' services and to ensure that skill requirements remain largely unchanged. The speed with which port labour regimes, collective agreements and work practices translate market signals into responses from dockworkers is the key to commercial success in a global marketplace. Attempts to guarantee job security and income for dock labour cannot make ports attractive, even as social entities, unless they enhance the commercial viability of users in world markets.

2. Dockworker participation

The knowledge, experience and intelligence of those who actually provide cargo-handling and storage services is a resource that can make a major contribution to the earnings and competitiveness of ports and private terminal operators, but efforts to take greater advantage of these qualities are often viewed by maritime employers as an encroachment on management prerogatives and by port labour leaders as an effort to undermine union solidarity (ILO, 1981, pp. 29-35). It is often suggested that management prerogatives are derived from the principle of ownership and that dockworkers will have such power only if they are also proprietors. It is also asserted that dockworker participation in earnings and management decisions is a natural consequence of those workers' investment of their labour in the enterprise, just as other people invest capital (ILO, 1981, pp. 14 and 20). Each of these arguments seeks to justify dockworker participation in earnings and workplace decisions on the basis of an initial attribute (ownership or

investment), but the basis for this does not lie in some syllogism or circular argument. Rather, it lies in an understanding that dockworkers have a wealth of useful experience that can be utilized to improve productivity, lower costs, enhance the earnings of users and maritime employers, and satisfy their own opportunity-oriented social goals.

3. Modern technologies and dockworker skills

For dockworkers to properly serve users, to enhance the competitiveness of exports in international markets and to preserve their own jobs, it has become essential that they respond to market signals, utilize advanced technologies and accept training programmes. These changes create a stressful situation for port labour. To create a basis for their acceptance, port labour must be offered a counterbalancing human response, which has been referred to earlier as opportunity-oriented social equity. The main limits to the acquisition of new skills are likely to lie in the capabilities of each individual to cope with enlarged work requirements and responsibilities. Unions were very strong when port labour was an undifferentiated mass of workers in need of representation, but today a much smaller group of highly skilled employees carries out the same operations with very sophisticated equipment. This can lead to a weakening of the port labour movement if dockworkers reject new technologies and are unwilling to negotiate collective agreements which permit their efficient utilization. Modern technologies permit the expansion of dockworkers' skills and knowledge from the capacity to operate one type of machine to an understanding of port operations, and then to an awareness of how port services fit within a broader perspective of trade requirements.

TABLE 1

**United States (West Coast ports):
Impact of containers on dockworker productivity**

Year	Man-hours worked (millions)	Tons of cargo handled (millions)	Productivity (tons/man-hour)
1960	29.1	28.5	0.98
1980	18.5	113.7	6.15
1987	17.1	157.8	9.23
1993	15.7	183.6	11.69
1994	17.0	199.0	11.71

Source: Pacific Maritime Association.

As an illustration of the decrease in the demand for dockworkers due to modern technologies, the handling of dry-bulk cargoes in the early 1950s at U.K. ports required 20 men for each cargo hold of a vessel. Today, the loading of grain is carried out by three men, even though the technology utilized would permit one man to execute all operations (Davies, 1993b, p. 8B; *The Journal of Commerce*, 1993a). With regard to marine containers, table 1 demonstrates the experience of container handling systems at U. S. West Coast ports.

As can be seen from this table, container handling systems allowed the number of dockworker man-hours required to be reduced by 41.6% (from 29.1 to 17.0 million) between 1960 and 1994 although the volume of cargo handled increased 6.98 times (from 28.5 to 199 million).

4. Efficiency

This concept is usually defined in vague terms, such as the satisfaction of wants within resource and technological constraints (Eatwell, Milgate and Newman (eds.), 1987, pp. 107-108). For the purposes of this article, port efficiency refers to the provision of cargo-handling and storage services which satisfy users' needs in the most productive and cost-effective manner possible. This suggests that the wage and benefit gains of dockworkers would be considered efficient if they are based on productivity increases, and do not restrict or negatively influence the commercial activities of users and maritime employers. Put another way, port efficiency depends on price competition among maritime employers and productivity competition among dockworkers. Governments can contribute to the improvement of port efficiency by formulating an institutional framework which permits the unimpeded interplay of market mechanisms to balance their own interests, the social goals of labour and the commercial objectives of users.

As an illustration of this point, the International Longshoremen's Association (ILA) at the U. S. East Coast port of Philadelphia has agreed to utilize fewer dockworkers in shifts of nine hours without any additional pay when unloading vessels carrying Chilean fruit and has formulated a plan to continue such operations during labour disputes so that shippers would not utilize other ports (*The Journal of Commerce*, 1993b, p. 1B; *América Economía*, 1993, p. 36; Di

Benedetto, 1991, p. 8B; Knox, 1991, pp. 1B and 8B; Benedict, 1990, pp. 28-29). Nevertheless, the port has been losing Chilean fruit to the neighbouring port of Wilmington (Delaware), where charges are 40% less even though dockworkers are members of the same union (Monk, 1995, p. 10B; Holcomb, 1994b, p. 7B; *The Journal of Commerce*, 1993c, p. 1B; Holcomb, 1993b, p. 5B; Johnston, 1993, p. 8B; *Fairplay International Shipping Weekly*, 1993, p. 27). ILA dockworkers at the port of Philadelphia responded to this competition by accepting a reduction in their wages from US\$21 per hour to US\$18.50 for breakbulk cargoes, and to US\$16.50 for Chilean fruit. Members of a road hauliers' union, the Teamsters' Union, perform the same work for only US\$11 an hour, however.⁵ To the extent that dockworkers are exposed to inter-port, intra-port, inter-union, intra-union and non-union competition, it is all the more likely that users' efficiency needs will be met.

Latin American port union leaders frequently assert that dockworkers' wages are insignificant and do not permit them to meet their basic needs, while users and maritime employers disagree, declaring that they greatly exceed those of some other regions. Both statements are true. This would suggest that an efficient allocation of resources has not been achieved because labour and port costs do not respond to market signals. For example, port workers at Callao (Peru) made important concessions regarding their remuneration. The big mistake was that the reduction in dockworkers' wages was not subject to the competitive influence of market mechanisms. The benefits of the reduction in wages were, instead, allowed to fall into the hands of ships' agents, thereby maintaining the same cost structure which requires that port charges and ocean freight rates remain the same. Once such politically obtained advantages are freed from the control of one group, they should be subjected to the open, competitive pressures of the marketplace. This will ensure that the unimpeded interplay of market mechanisms on relinquished concessions and rights will contribute to progressive improvements in port efficiency.

⁵ Holcomb, 1993a, p. 5B and 1994b, p. 1B; Abrams, 1994a, pp. 3C and 4C and 1994b, p. 8B. For details of inter-union competition at U.S. West Coast ports, see Mongelluzzo, 1995, p. 1B.

IV

Institutional mandates

The age-old procedure whereby a master and his apprentices accepted responsibility for the cost and quality of goods ended with the mass production of standardized goods as a result of the Industrial Revolution. This permitted employers to reserve all decisions for themselves and labour was simply required to follow their instructions. With the advent of worldwide sourcing of inputs and manufacturing, automated production processes, electronic information systems and the competition of a global economy without frontiers, however, workers have come full circle and returned to the point where they started: individual responsibility for the cost and quality of goods and services. A reformed institutional framework for port labour which reflects this change does not mean that dockworkers will be denied any of their traditional rights, but that such rights are neither superior nor inferior to those of users and maritime employers. The foremost problem in reformulating the institutional framework for port labour is, quite succinctly, that the port labour movement lacks vision when it comes to identifying and defining appropriate roles for its members in a commercial environment which does not permit registration systems, cargo-handling monopolies and government subsidies.

1. Market mechanisms

Market mechanisms –supply and demand, profit and loss, economies of scale, customer likes and dislikes, and the threat of bankruptcy– offer external standards to control the size of the workforce which balance the desire of dockworkers and maritime employers for monopoly privileges and compel each to progressively improve productivity, reduce costs, innovate and make needed investments. The worldwide sourcing of inputs and manufacturing has been engendered by the advent of a global economy and the introduction of open-market growth policies, and it represents a separation of national production and consumption functions. Mass production is based on mass consumption, and factory owners' prosperity was therefore tied to that of

their workers. Today, however, enterprises combine labour, capital and material inputs from numerous nations and sell their products in yet other nations (Handy, 1994, pp. 200-201; Reich, 1992, pp. 110-118 and 263-265; Marshall and Tucker, 1992, pp. 32-33; Porter, 1991, pp. 14-15). They ensure their goods are competitive in very demanding international markets by controlling the cost of each input and maintaining high productivity, both of which directly influence the job security and compensation of labour.

The multiple –political, social, commercial, technical, operational, legal and environmental– realities of ports are unavoidable, but the importance given each and their relevance will be distinct in a global economy. Dockworkers can no longer be isolated from the competition facing users and maritime employers and the risk of bankruptcy facing them. Such challenges can only be met by exposing dockworkers to the competitive influence of market mechanisms. Governments must deregulate the port labour market to remove regulatory obstacles to the free play of market mechanisms as they affect supply and demand, and they must decentralize collective negotiations to ensure that they are subject to the commercial influence of local markets. The essential goal of port labour reform is to enhance the attractiveness of ports for users and the competitiveness of the goods handled in international markets, while creating a social-commercial basis for dockworkers to obtain wages and benefits. By subjecting dockworkers to the influence of market mechanisms, they will come to see that their future lies not in government largesse but in fulfilling users' needs.

2. Governments

Governments are socio-political contracts between elected officials and citizens, in which the former listen and react to the stronger and better organized groups of the latter. Labour unions are a dominant force in port matters, and their alliances with elected and appointed government officials and political parties provide labour leaders with substantial influence

over legislative, regulatory and policy-making processes. Port-labour monopolies, registers and subsidies in the ECLAC region were created through a process of commission and omission over many decades by governments of the entire political spectrum. Governments need to abandon their deep-seated tendencies to resolve commercial problems with political means, to assume that national policies and legislation are above the market mechanisms, and to utilize port labour as a political instrument. Governments can no longer isolate dockworkers from the competitive requirements of the international labour market, because export-led policies have thrust them into the global economy; they can no longer engage in commercial activities unless they have the profit motive and the requisite skills; and they can no longer employ dockworkers under bureaucratic arrangements which demotivate them.

The prime objective of governments in restructuring the institutional framework governing port labour should be to create a market-oriented environment in which people and groups who need to cooperate with each other, despite conflicting or incompatible interests, utilize the common external standard of market mechanisms to forge credible and enforceable agreements. To achieve that objective, maritime employers must be able to respond to market signals, port labour should have access to managerial information and the right to participate in workplace decisions, and both need to be free from the influence of non-labour, non-management groups in collective negotiations. Government efforts to create a commercial labour framework for ports will succeed only if they remove themselves from direct involvement in labour relations. This will not affect their responsibility to formulate a market-responsive institutional framework which outlines the requirements for workplace safety, minimum wage levels, settlement of disputes, compensation for displaced workers and training (Ruiz-Tagle, 1991, pp. 99-124).

3. Port labour regimes

The capacity of manufacturers to utilize inputs, factories and assembly installations worldwide means that they can create competitive advantages by controlling the supply, cost and quality of raw materials, decreasing labour costs, obtaining needed worker skills, improving production and distribution efficiency, and positioning themselves for admittance

into final markets (Baker, 1994, pp. 106 and 108). This means that port labour is an input into production processes, just as are raw materials and factory labour, and it is exposed to the competition and performance standards of the international labour market. Governments should ensure that such standards for dockworkers do not arise from measures such as registration systems, cargo-handling monopolies and government subsidies, but from responses to market signals reflecting users' needs. Market-based reform of port labour regimes should foster a new era of labour-management relations based on mutual respect, open communications, shared decision-making and joint obligations in the areas of productivity, cost control and innovation (Swoboda, 1993, p. C3; Bluestone and Bluestone, 1992, pp. 5-8 and 17-19).

Maritime employers should not be allowed to dismiss workers without cause, ignore provisions of labour regimes and collective agreements, or enter into arrangements with other employers to refrain from hiring discharged workers or to limit wage and benefit increases. For example, certain employers in the ECLAC region have developed the practice of simply not responding to the demands of workers to negotiate collectively within stipulated time periods, in order to create an image of indifference and inflexibility on their part (Abrams and Trischwell, 1994, p. 1B; De Paula Leite, 1993, pp. 94-103; Bluestone and Bluestone, 1992, p. 202; Piñera, 1990, p. 134). Port labour should not be allowed to disrupt cargo-handling activities, work slow, cease working during the validity of a collective agreement, avoid compliance with provisions of national labour regimes which require a suspension of strikes, limit the establishment of other unions in the same workplace, sidestep direct and secret elections for officers, exercise monopoly control over cargo-handling and storage services, or place limits on the utilization of advanced cargo-handling technologies or on the selection of dockworkers.

At the practical cargo-handling level of port operations, port labour reform means that dockworkers have to acquire new skills and accept new operational practices. The risks inherent in the reformulation of labour regimes are that each member of the port and trade community will resist different aspects of every change. Maritime employers might oppose an open competitive environment because it would eliminate a guaranteed return on their

investments and they would have to make contributions to training programmes, while dock labour could be equally reluctant because it faces uncertainty with regard to job security, wages and benefits, and governments could view such reforms as provoking voter disenchantment. The balancing of these factors with the external standards of market mechanisms should ensure that users have a commercial opportunity to achieve their goals. Due to the comprehensive nature of such changes, only if governments are able to isolate legislators from the influence of port labour and maritime employers, and *vice versa*, will these factors become part of market-based port labour regimes.

4. Collective negotiations

Agreements which control the relationship of maritime employers and port labour for a specified period of time are formulated through collective negotiations. In the past, the low skills required of port workers meant that they were easily replaced and created an imbalance in bargaining strength between them and their employers (Edwards, 1993, pp. 13-14; Matos Mar, 1988, pp. 309-352; Brezzo and Vispo, 1988, pp. 413-443).⁶ Governments began participating in such negotiations in order to make them more balanced, administer and validate the resulting agreements, and resolve controversies (Díaz Corvalán, 1993, pp. 114-121; Solimano, 1988, pp. 135-158). However, the absence of an unbiased basis from which to judge the demands of port labour and the position of maritime employers leads to confrontation in collective negotiations because labour regards the issues from a social standpoint, employers see them in their commercial dimension, and governments consider them as a means to redistribute national wealth as well as to fulfill their own political aspirations. Dockworker registration systems, cargo-handling monopolies and government subsidies have been utilized for decades to bridge the gap between commercial, social and political goals, but the competitiveness of a global

economy requires that they be replaced by market mechanisms.

Direct government involvement in collective negotiations has become unworkable because the competition in a global economy intensifies the differences between commercial, political and social goals, and limits the means governments might utilize to harmonize them. The reformed labour regime would remove the public sector as a direct participant in collective negotiations and replace it with market mechanisms. The goals of balancing negotiating interests, motivating dockworkers and avoiding political pressures can be reached through a regulatory framework which exposes the negotiating parties to market mechanisms and ensures that they can utilize such mechanisms only to compete. In this context, collective negotiations can make a positive contribution to the productivity and cost-effectiveness of port labour. The major fear of governments, maritime employers and port labour unions in collective negotiations should not be of each other or of the possible failure to achieve their respective goals, but of the danger that they might create a port which is commercially unattractive to users and which cannot compete in a global economy.

5. The port labour movement

The labour movement in the ECLAC region has been losing members and is now concerned about its survival: for example, union membership in Chile declined from 33.7% of the workforce in 1973 to 11.2% in 1985, although it recently recovered to 13.7% in 1994 (ILADES, 1995, pp. 1-4). As this mirrors a trend in many other countries, the port labour movement must generate ideas to improve productivity and control costs which demonstrate to users and maritime employers that their commercial future lies with unionized dockworkers. No longer can union demands be made outside of the commercial framework facing users and maritime employers. The social collectivism of the port labour movement as an organizing rationale for workers will be ever-increasingly questioned in the highly individualistic work setting of modern ports, but the need for a focal point for labour and maritime employers to formulate responses to the competition of other ports and terminals will remain beyond doubt (Bluestone and Bluestone, 1992, pp. 150-152). If the port labour movement is to reconceptualize its role in the global

⁶ This also reflects one of the International Labour Organisation's oldest and most basic tenets: the adoption of various conventions and recommendations which establish international labour standards at tripartite -governments, management and labour- international labour conferences. See ILO, 1983, p. 10.

economy, it has to strengthen its voice in commercial matters with maritime employers in order to safeguard its own jobs, earnings and benefits (*The Economist*, 1993b, pp. 37-38; 1993d, p. 40, and 1993c, p. 102).

The vested interests of the port labour movement, governments and political parties in existing port labour regimes represent the sources of resistance to their market-based revision. The competitive pressures arising from the emergence of a global economy, introduction of export-led growth goals, and utilization of modern cargo-handling and information technologies should be able to eliminate such resistance if registration systems, cargo-handling monopolies and government subsidies are replaced by market mechanisms, if collective negotiations and the port labour market are deregulated and decentralized, if private interests are allowed to invest in and operate public-sector ports, and if port labour and maritime employers collaborate to improve productivity and reduce costs. With the shift to capital-intensive systems, dockworkers have become highly skilled specialists and the port labour movement should propose that dockworkers be treated on an individual basis as regards salary, pension, health benefits, life insurance, training programmes, career objectives and vacations, in order to provide each worker with an incentive to improve his contribution to port efficiency (*The Nikkei Weekly*, 1994, p. 12; Heldman, Bennett and Johnson, 1981, pp. 135-136).

Labour leaders must have the confidence of their members to carry out the formidable task of transforming unions from socio-political into socio-commercial institutions. For example, the Latin American Shipping Services Association, a liner conference, informed the port administration at the Central American port of Santo Tomás de Castilla (Guatemala) that a theft surcharge of US\$200 would be imposed if the high rate of cargo theft is not stopped (*International Transport Journal*, 1994, p. 2837). Labour leaders at that port found themselves without support, however, when they suggested to members at a meeting that there were those among them who should not be ac-

cepted, because they were malingering and pilfering cargoes. Just as legislators are elected to be agents of change, so also are union leaders, but they often have to act as advocates of the *status quo* in order to ensure their reelection (Curtis, 1994, pp. 34, 35 and 37). Both groups tend to shy away from vote-losing decisions and try to score political credits by criticizing unpopular but sensible innovations. Union leaders must not be reluctant to enforce commercial discipline on their members if it leads to increases in productivity and cost reductions, or to expose those groups of workers who are utilizing the ports for their personal enrichment.

6. Maritime employers

Maritime employers can provide the greatest benefit to users when guided by an in-depth understanding or strategic vision of the market, service, technological and legal forces which are continuously transforming the ports. This will permit them to anticipate the needs of users, to adjust to change, to invest, and to select, train and motivate dockworkers, and it will be the characteristic quality of successful maritime employers in a highly competitive global economy. In other words, maritime employers have to value skilled workers, be willing to share workplace decision authority, and make sacrifices to retain and retrain such staff, while dockworkers have to offer services which are innovative, productive and cost-effective, and they must be willing to accept changes in their functions that respond to the needs of users (Watts, 1984, p. 34). Maritime employers cannot function as though they were part of a government bureaucracy and isolate themselves from the commercial realities facing users. As they are facing a globally competitive market, they should make better use of their time and money because they have less of both for making investments, training dock labour and providing cost-effective services. Finally, maritime employers should seek to encourage dockworkers to develop a predisposition to progressively improve productivity and control costs.

V

The implications of port labour reform

A global economy limits a government's capacity to adopt measures which grant rights to labour if they harm the commercial attractiveness of a port, reduce the competitiveness of users' goods and services in international markets or lead to the creation of monopolies. Just as capital and labour are two measures of the same reality, so also are private participation in public-sector ports and market-based port labour reform. Private participation in public-sector ports brings to light the need for market-based port labour reform, and market-based port labour reform ensures that the goals of private entrepreneurs can be met. Without a market-oriented port labour regime, it will not be possible to establish a commercial basis for private participation; without private participation, the port labour movement will have little incentive to accept a market-based reform of their regulatory regime.

1. Economic implications

The adoption of market-oriented labour regimes will ensure that dockworkers' demands take into account the export-led growth goals of the nation, the competition faced by users, and the cost and productivity requirements of the international labour market. Dockworkers might be in a monopoly position at a specific port, but they are part of the global economy and have been ineluctably pulled into the international labour market, since they are forced to compete with their counterparts an ocean away if they are loading comparable goods for the same markets (Reich, 1992, pp. 120-122). Dockworkers will be motivated to respond to the needs of users if they can see that this is necessary in order to preserve their own earnings and jobs (Vernon-Wortzel and Wortzel, 1988, pp. 27-35). This will transform ports from places where dockworkers' wage and benefit needs are given priority by governments to places where the labour force will give preference to users' commercial goals. Those nations which yield to pressures from port labour and do not reform labour regimes will lose key opportunities to gain competitive advantages for their goods in international markets.

Conventional commercial boundaries will expand in a global economy. National markets, national producers, national labour goals and national strategic objec-

tives no longer occupy the paramount position they once did, because they have now begun to emerge from the closed-loop premises of a political economy. With the adoption of market-oriented port labour regimes, dockworkers will be exposed to the market forces of the international labour market and maritime employers will not have to pay them for the political value of their services. They will pay market-determined wages: no more, no less (Suárez, 1994, p. A2; Standing, 1992, pp. 327-354). This will allow maritime employers and port labour to satisfy users' needs through greater productivity, instead of trying to evade the problem through market protection and subsidies. An ECLAC study of the port labour reform process carried out in Chile has estimated the distribution of savings among users and the public-sector port authority, based on a comparison of the resources employed in 1980 and 1986.⁷ Table 2 demonstrates that the actual savings enjoyed by users are substantial.

Maritime transport employers and port labour will be concerned with the cost and productivity of each other's activities because their commercial viability in a global economy is related to the value added or taken away by each of them. For example, the annual savings which users of Chilean ports enjoyed as a result of the 1981 labour reform were US\$40 million in 1982, and by 1993 they exceeded US\$118 million, which was a little less than the US\$121 million recorded the year before (Cámara Marítima de Chile, A. G., 1993, p. 26, and 1992, p. 28). This will lead to closer integration of users, maritime employers and dockworkers, and will compel the providers of port services to respond rapidly to changes in the demand for goods, routes and technologies. Dockworkers and maritime employers will jointly seek not only to increase the efficiency of cargo-handling services but also to improve the wages, benefits and job security of port labour, because they have the same economic goal: to make the port more commercially attractive to users.

⁷ ECLAC, 1989, pp. 36-41. With regard to French ports, see *Containerisation International*, 1993, p. 25: "...as Marseilles pacifies".

TABLE 2

**Chile: Estimated distribution of savings following
deregulation of the port commercial environment**

Product	Unit	Saving ^a		
		Owner of vessel or cargo	EMPORCHI	Total
Fruit	US\$ per case	0.14	0.14	0.28
Copper ingots	US\$ per ton	6.70	-4.05	2.66
Fishmeal (in bags)	US\$ per ton	4.61	1.57	6.18
Sawnwood	US\$ per m ³	2.81	1.63	4.44
Roundwood	US\$ per m ³	2.73	0.63	3.36
Imported breakbulk cargo	US\$ per ton	3.55	3.22	6.77

Source: Ingenieros y Economistas Consultores Ltda. (INECON).

^a Minus sign indicates a loss.

2. Political implications

The most salient political consequence of labour reform would be the withdrawal of governments from direct participation in port labour relations, except as regulators, owners and promotional investors. This should not lead to abuses, because the common external standard of market mechanisms would take the place of the governments. Regulatory functions would be limited to the establishment, reinforcement and protection of competition, and to formal dispute resolution. Commercial success will no longer arise from political alliances or from dockworker registration systems, cargo-handling monopolies and government subsidies, but from the possibility of mobilizing factors of production on a worldwide basis to assemble a viable product-service combination that can compete in demanding international markets. Market-oriented port labour regimes require governments to be aware of market mechanisms, to understand what they mean for dockworkers and maritime employers, and to shield legislators from the pressures of dominant groups. Such a framework will transform unions from political actors who utilize government processes for the exclusive benefit of their members into innovative "joint venturers" with maritime employers who practice self-help in order to improve their wages, benefits and job security, while at the same time helping users to achieve commercial goals.

3. Social implications

The highly competitive global economy into which ports have been plunged does not permit governments to impose social programmes on maritime employers without regard to the commercial environment facing

users. Private sector participation in services and state-of-the-art facilities are a necessary condition to reach commercial objectives, but they are insufficient without a labour force that is well-trained, highly productive and cost-effective. As the commercial success of maritime employers is intimately linked with the hard work, loyalty and skills of dockworkers, human resources have a decisive role in creating port services which are attractive to users. Maritime employers should recognize that commercial objectives are intertwined with the social goals of dockworkers, and that neither can be achieved independently. Thus, there is a social base to commercial success and it compels maritime employers to go beyond enterprise efficiency and earnings to train and motivate employees, promote loyalty, collaborate with them and ensure their well-being.

The longer-term implications of the interdependence between commercial and social goals mean that maritime employers and port labour must seek to avoid intensifying their disputes in the confrontational court and arbitration systems because they will have to work together to reach consensus-oriented objectives which require intangibles such as the dynamic best efforts and goodwill of both sides (Cabot, 1986, pp. 14-15). A shift in labour relations from confrontation to common objectives will lead to a greater commercial awareness on the part of port labour and a greater social consciousness on the part of maritime employers. The "social question" voiced at the beginning of this century for dockworkers will expand to encompass a "competitive question". Whether port labour unions and maritime employers accept and respond to the competitive question and shared values depends not so much on their goodwill as on the political resources available to governments for formulating an institutional framework which en-

tures that both parties are subject to market mechanisms. Dockworkers will have to pledge their loyalty to users and maritime employers rather than to

elected and appointed officials, if they are to make the port and terminal commercially attractive and enhance their own wages and benefits.

VI

Conclusions and recommendations

It is hard to imagine the port labour movement in a more difficult situation: it has been unable to come up with a plan which would help dockworkers shift from a monopolistic to a competitive work setting; technical advances are reducing the demand for dockworkers, making them more productive and compelling those that remain to update their skills; export-led growth policies have exposed them to the borderless competition of a global economy; the effectiveness of political alliances, dockworker registration systems, cargo-handling and storage monopolies and government subsidies have declined; there is a growing disenchantment with the labour movement, as workers seem to be moving away from a collectivist approach towards some form of protected autonomy; and governments have begun to take the first steps towards creating a basis for private participation in port services and port installations.

1. New roles for governments

Governments have to utilize the components of market-sensitive port labour regimes in order to achieve commercial objectives and opportunity-oriented social goals. They should eliminate their own direct participation, as well as that of political parties, international organizations, foreign labour unions, universities, the military and the families of dockworkers from port labour relations, so as to avoid pressures which seek to modify market outcomes. Governments should ensure that reformed labour regimes permit market mechanisms to generate commercial opportunities for users and maritime employers, as well as more satisfying and flexible work assignments and greater benefits for dockworkers. The task governments face is not just to abolish registers, monopolies, subsidies and alliances, for some means can always be found for their reestablishment, but to create an institutional framework which utilizes market mechanisms to reconcile the interests of maritime

employers and port workers for the benefit of users, while using the intelligence and problem-solving capacities of dockworkers to enhance enterprise competitiveness. Governments themselves are not subject to market mechanisms, but they are not isolated from the commercial realities facing users and maritime employers.

Governments should adopt a port labour regime which deregulates the supply and demand of port labour, decentralizes collective negotiations to the level of individual maritime employers, and utilizes anti-monopoly laws to remove limits to competition so that the demands of users, maritime employers and dockworkers will be balanced and reconciled by market mechanisms. These tasks are almost entirely a political undertaking, but governments must ensure that commercial and social goals are treated equally and that political processes are not utilized to impede or distort their realization. With the incorporation of national factors of production into global markets, collaboration between maritime employers and port labour will become essential for commercial viability and job security. Governments should ensure that reformed port labour regimes unite the interests of port labour and maritime employers through the establishment of joint obligations in the areas of productivity, cost-control, training and career growth, thereby fomenting collaboration and creating a basis for reconciling commercial and social goals. Governments are responsible for the socio-political atmosphere in ports, and the obligation to help dockworkers shift from a monopolistic to a competitive work setting rests with them.

2. A market-based port labour regime

During the era of paternalistic port labour regimes, unions had a socio-political orientation based on the doctrine of "social betterment through labour" and were a major force in national politics. The strength

of the port labour movement today, however, increasingly depends on the capacity of dockworkers to add value to users' goods and services, and profitability to their employer's activities. A "social betterment through trade" doctrine will be no more successful than its earlier counterpart unless port labour and maritime employers are exposed to market mechanisms. There is nothing inherently wrong with barbers cutting dockworkers' hair free, provision of free buses to transport dockworkers between their homes and the ports, requirements that maritime employers must hire the sons of dockworkers when their fathers retire, provision of recreation facilities for dockworkers, dockworker registers, government subsidies, minimum wages and guaranteed work weeks, unemployment benefits, and retirement and health programmes: the only problem is that they were obtained by the port labour movement outside the commercial boundaries established by market mechanisms.

Port labour unions will allege that subjecting these social conquests to market mechanisms will have grave consequences such as creating massive redundancies and permitting maritime employers to utilize the new emphasis on commercial goals to increase their earnings at the expense of dockworkers. Nothing could be further from the truth, however, if both port labour and maritime employers are equally deregulated and decentralized, subject to antimonopoly laws, and supported in the case of workers by compensation and retraining programmes. With the increasing technical sophistication of cargo-handling operations, and the utilization of opportunity-oriented social equity to provide redundant dockworkers with compensation and retraining programmes, there is no legitimate reason for governments to delay their efforts to formulate market-oriented port labour regimes. However, governments normally make changes based on a consensus, and without it the possibility of losing the votes of dockworkers who become disenchanted with them could easily overshadow desirable commercial and social goals.

The formulation of market-based port labour regimes requires governments to act in a transparent, impartial fashion, to possess the capacity to filter out utopian dreams and monopolistic habits so that commercial and social goals may be exposed to market mechanisms, and to organize the entire port community to participate in the process. Informal dispute resolution guidelines prepared by governments can provide port labour leaders and maritime employers

with an opportunity to go beyond wage and benefit bargaining and collaborate with each other concerning alternative organizational structures, work practices and technologies that might be utilized to achieve commercial and social goals. For the reformed institutional framework to be viable, it should provide maritime employers with sufficient flexibility to select the most skilled workers, assign tasks and offer needed training programmes so that users' needs may be met. Such a framework will require frequent updating to respond to changing market conditions and constant monitoring to ensure compliance with its provisions. This can most easily be accomplished by creating a commission within the Ministry of Labour which is required to consult with the port community regarding changes to the framework that might improve productivity and cost-effectiveness.

3. An implementation strategy

Port labour unions will seek to preserve jobs and safeguard the wages and benefits of their members through socio-political measures. Maritime employers, for their part, will attempt to obtain flexibility in hiring and discharging workers, changing task demarcations, and varying wages and benefits according to worker experience, productivity and the completion of training courses, so as to ensure the commercial attractiveness of port installations to users. To reconcile these conflicting objectives, governments should formulate implementation strategies which give dockworkers a feeling of mutual support, an understanding that change is inevitable, an outline of the roles they will play during and after changes, and confidence that investments will be made in their welfare. The loss of jobs and privileges will not be easily accepted by port labour, so governments should publish criteria for selecting the persons who will be made redundant and those who can undertake retraining programmes, together with a simplified scheme which will permit dockworkers to calculate their compensation and retirement benefits.

Governments should form teams composed of persons from the Ministries of Finance, Trade, Transport, Public Works and Labour, as well as from users' groups, port labour unions, maritime employers and port administrations, to work out market-based port labour regimes and implementation strategies. The efforts of such teams will naturally give rise to uncertainty among dockworkers and lead unions to claim

that the social costs are prohibitive. In response to this assertion, the teams, users and maritime employers should join forces to prepare studies which demonstrate that such reform is mandated by the global economy, that commercial and social objectives can be harmonized by subjecting them to the common external standard of market mechanisms, and that they are willing to share the burdens and benefits of the new labour regimes with port labour through compensation, retraining and retirement

programmes. These measures are the counterbalancing human response—the social equity dimension—of an implementation strategy for port labour reform and should set at rest the fears that the new regimes will have high social costs, that dockworkers are the ones who will bear the entire adjustment burden, and that port labour problems have not been resolved but merely transferred to another sector of the economy.

(Original: English)

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New trends

in wage policies

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Up to a few years ago, wages policy was a central instrument of macroeconomic policy in Latin America, and there was a great deal of State intervention in it. Now, in the early part of the 1990s, however, the countries of the region are mostly in a more balanced macroeconomic situation and have gone a long way in their process of trade openness. Both these factors heighten the importance of costs, in view of the need to maintain the competitiveness of national production, so that the search for instruments to facilitate control over costs, including labour costs, is now a constant concern. These changes of circumstances and of approach have reduced the role of the State in the area of wages and have transferred the matter to the enterprise level. With regard to wages, there are constant references to the need for wage flexibility and the need to link wages to productivity, although emphasis is usually placed on the supposed macroeconomic benefits to be derived from this approach. This article holds that not enough importance has been attached in the consideration of this issue to the motivational aspects at the enterprise level and the changes needed in the organization of the latter, and it is suggested that flexible wage systems must be adapted to the characteristics of the enterprise concerned if the latter is to attain its strategic objectives.

I

Introduction

As in various other areas of economic policy, wages policy is subject to changes designed to adapt it to the prevailing economic circumstances and further the achievement of certain objectives. In recent years, there have been a number of important changes in the wage policies of various Latin American countries, which may be summed up as the abandonment of policies of intervention in wage fixing in favour of a more flexible position.

In some countries, this change has been related mainly to the process of adjustment and recovery of some degree of macroeconomic balance and to the process of trade liberalization,

which demands greater international competitiveness. These two processes have given rise to a change in the approach to wages policy, which was heavily dominated by State intervention up to a decade ago, but which now tends towards the determination of wages at the enterprise level. The recurrent issues in this new approach are labour costs (among which wages are an important factor), productivity, the attainment of more flexible control over company costs (in which a variable wage component is one of the options) and factors of motivation (among which some forms of remuneration may play an important role).

II

General objectives in fixing wages

The main objectives pursued in wage fixing, along with other macroeconomic policies, may be grouped around four concepts: equity, macroeconomic stability, efficient allocation of labour, and operational efficiency.¹

With regard to equity, it is necessary to distinguish between several different notions. First of all, equity is linked with income distribution and improvement of the situation of the most underprivileged groups. From this point of view, it is closely linked with the development process. Equity also depends on the application of the principle of equal pay for equal work. This same principle means that there will be different levels of pay for jobs that make different contributions to the production process, thus giving rise to differences of pay or remuneration based on performance. Finally, equity is also connected with the way wages are fixed, so that many countries assign a positive role to collective

negotiation, which gives employers and workers broad opportunities to participate in decisions affecting their conditions of employment.

The natural desire for equity is subject to a number of economic objectives, among which macroeconomic stability occupies a leading place. When appraising systems of fixing wages, it is therefore important to verify whether they facilitate or hinder price stability, job creation, growth of production and equilibrium of the balance of payments. As we shall see later, these considerations have occupied and still occupy a leading place in the Latin American countries.

Systems of fixing wages should contribute to the efficient allocation of labour by providing incentives for workers to move from activities where there is a surplus of labour to those where there is a shortage. These changes should promote the movement of human resources to the sectors of highest productivity, thus helping to increase the overall efficiency of the economy.

Finally, the fixing of wages has an essential role to play in the operational efficiency of the enterprise, by maximizing production for a given level of capital

¹ For a more detailed discussion of these objectives, see ILO, 1985a.

and human resources. The efficiency of the company can be stimulated through the introduction of remuneration conditional upon improvements in labour productivity. At the same time, however, the remuneration must seem fair to the workers, because otherwise it may give rise to open conflicts (strikes) or concealed problems such as high levels of absenteeism or worker rotation or low levels of motivation.

Obviously, among these four objectives macroeconomic balance is that which is furthest removed from the company level, while operational efficiency is closest to it. In spite of this

difference, however, the two are interrelated. Issues having to do with the achievement of macroeconomic balance, such as inflation or the balance of payments, will always form the framework for the determination of wage adjustments, for example. At the same time, these objectives often involve opposing demands, so that it is necessary to formulate wage policies which take them into account and sometimes lead to intermediate solutions. If, however, an objective is considered so primordial that other objectives are left aside, then it is almost inevitable that there will be imbalances.

III

Wages policy as an instrument of economic policy

In recent decades, wages policy has been one of the instruments most frequently used to attain macroeconomic balance in a number of Latin American countries. This has been particularly so in countries which have suffered high rates of inflation and hence had to make periodic reviews of nominal wages. Within this context, State intervention in the labour market became increasingly important and complex and took various forms.

One form of State intervention was through policies for fixing wages in the public sector, which employs a substantial proportion of the urban labour force in developing countries.² Another was the expansion of the public sector towards production activities through the establishment of public enterprises, thus extending its influence to a sector in which working conditions were similar to those obtaining in the private sector. Minimum wages were also an important means of intervention: from the earliest stages in the industrial development of Latin America, minimum wages played the dual role of establishing an important yardstick for industrial

investment while at the same time guaranteeing a minimum level of income for the wage-earning population.

As regards the influence of wage policy on the private sector, the experiences registered have been of a varied nature, as State intervention has taken various forms (ILO, 1991). Bipartite negotiations without direct State intervention represent the least interventionist version. It should be noted that this option requires well-developed trade union and employers' organizations and can best be adopted in situations where collective negotiation covers a substantial proportion of the labour force.

State participation in wage fixing increased in line with the State's power to act as an arbitrator in collective negotiations. Later on, in certain periods when such negotiations were suppressed or restricted, this arbitral function was converted into the direct establishment of general and sectoral rules on wage adjustments. In some cases, these adjustments directly followed the various economic policies. In other cases, the introduction of some indexing system led to a more autonomous adjustment process. Almost all the Latin American countries used some form of intervention through different types of indexing systems, either legally established (as in Brazil) or applied on an informal but very widespread basis.

² It is calculated that in the period between 1975 and 1985 total public sector employment absorbed an average of some 20% of the non-agricultural labour force in Latin America and some 30% in Africa (Marinakis, 1994).

IV

Wage policies during the adjustment

In Latin America, State intervention at the different levels of wage fixing probably reached its height in the 1980s. The effectiveness of this intervention went down as wages policy became more complex, however. The overlapping of policies and their multiple objectives often led to incompatibility in different areas, because of the difficulty of establishing general criteria which satisfied the special features and needs of different sectors.

With the external debt crisis, restoring macroeconomic balance became the prime objective, conditioning the other objectives and often running counter to them. Thus, containing wage levels became the basic aim of the public sector and of the wage guidelines fixed by the authorities for the private sector (such as minimum wages, rules on indexing, or ceilings for collective bargaining). The consequent fall in real wages has led in many cases to a number of maladjustments which, although they originated in public sector policies, have an impact on the labour market as a whole. While not wishing to indulge in generalizations which may not always be appropriate, it may be said that this policy led to severe maladjustments of a similar nature in many countries. These maladjustments may be classified as those connected with the wage structure and performance, and those connected with remunerations proper.

1. Maladjustments connected with the wage structure and performance

The fall in public sector real wages led to the departure of part of the most productive and highly-trained staff, especially at the higher levels. Moonlighting spread and became an accepted practice, absenteeism increased, and illicit practices grew. As a way of

making up for wage freezes or the drop in real wages, the promotion process was speeded up, thereby distorting salary scales.

Government intervention through income policies was generally directed only at the lowest wage levels, and it often imposed freezes or severe restrictions on adjustments. Despite the legal restrictions—or because of them—companies sometimes increased other forms of remuneration, depending on their capacity to pay. This had two important effects. On the one hand, it made wage structures more complex, so that in many cases the instruments used have not served the interests of the workers or of the company. On the other hand, since they do not form part of the basic wage, such forms of remuneration have not been taken into account when determining pensions, for example.

Because of the fall in investment in capital goods, the necessary balance between capital and current expenditure was upset (more noticeably in the case of companies and public services than in the civil service), causing serious declines in the efficiency of the services provided.

2. Maladjustments connected with remunerations

Real wages fell in all areas of the public sector, but the budgetary item corresponding to wages and salaries continued to be very substantial, since at the beginning the level of employment was maintained unchanged.

In many cases salary scales were compressed, either because the increases granted to the lowest levels exceeded those of the upper levels, or because the increases were a fixed sum which naturally had a greater impact on the lowest wages.

V

Wage differences

Wage differences between the public and private sectors increased to the benefit of the latter; the differences between regions of the same country increased when those countries had decentralized structures, and the differences between the civil service and public enterprises increased in favour of the latter.

Towards the end of the 1980s, State intervention in wage policy went down appreciably with the application of certain policies linked with the adjustment programmes. In many countries, for example, the size of the State was reduced as a result of policies of cutting public employment and, in particular, of the big privatization programmes undertaken. This undoubtedly reduced the percentage of the population which depended directly on public wages policy.

A second example of the reduced weight of the State in wages matters was the evolution of minimum

wages. In most Latin American countries, real minimum wages went down considerably during the 1980s. What had originally been an indicator of the stabilizing intentions of the authorities ended up as a signal of flexibilization of the labour market. In many cases the minimum wage lost its significance, because it ceased to have any relation with some type of basic shopping basket or given level of purchasing power, thus raising the question of the need for periodic reviews of the way it was determined.

Finally, the stabilization achieved by some countries lightened the burden of frequent wage adjustments and indexing problems and led the authorities to encourage the linking of wage increases to productivity improvements, although without specifying how this should be done. This change of approach reduced the State's role in the area of wages and naturally transferred wage discussions to the enterprise level.

VI

The renewed importance of labour costs

As already noted, there was a change in the situation displayed by the Latin American countries in the 1980s. Now, in the first years of the 1990s, most of them are in a more balanced macroeconomic situation, with levels of inflation which are very low for the region. This different profile gives a new dimension to the cost evaluations made by companies. In the past, the high levels of inflation on the one hand made the estimates less accurate, but on the other hand they gave companies more leeway to pass on the higher costs to prices and to ensure that adjustments (i.e., reductions) in real wages could be achieved by omission rather than by action. Now, however, in countries with low levels of inflation greater control over production costs is needed.

At the same time, the process of greater trade openness which was begun in most of the Latin

American countries during the 1980s has been stepped up, partly because of an international trend towards liberalization. Greater openness and appropriate exchange rate policy are also pillars of the stabilization plans applied in a number of countries. This also heightens the importance of costs, because of the need to keep up the competitiveness of national production.

The renewed importance attached to costs has led to greater attention to labour costs, and this has been reflected in two areas. The first of these is the area of the regulations governing employers' contributions, seasonal bonuses, extra pay for holidays, allowances for various events such as compensatory payments or labour accidents, public holidays, etc. These factors have a big influence on the competitiveness of a country's firms in the international market.

Based on the costs involved in these regulations, a recent study compared the cost per hour actually worked with the net remuneration of workers in five Latin American countries.³ In Argentina, for example, for every 100 pesos received by a worker his employer has to contribute 103.5% more for every day effectively worked, while the corresponding contributions are 99.6% in Uruguay, 86.5% in Brazil, 61% in Paraguay and 53.8% in Chile (Bour, Susmel, Bagolini and Etchart, 1992).

The second area where labour costs have a major impact is at the enterprise level. In this case, the possibilities for changing the cost structure are connected with, among other things, the company's organization, financial structure and choice of technology.

Consequently, the search for instruments which provide greater flexibility of labour costs is now a constant concern of both governments and enterprises, especially in the most developed countries of the region. On the government side, the interest in making the labour market more flexible is due fundamentally to the desire to keep inflation down and create jobs. On the enterprise side, the objective is to control costs, because as the variations in their prices are now much smaller than in the past (when inflation rates were very high), it is hard for them to offset even the smallest increases in their labour costs. The common aim of both governments (through laws and regulations) and enterprises (through changes in organization) is to keep up or attain levels of international competitiveness.

Among other instruments aimed at greater flexibility on the labour side, various forms of more or less temporary hiring have been used, or certain services or parts of the production process have been contracted out. This type of flexibility is known as

external or contractual. However, there is a limit to this tendency towards more temporary arrangements, since it partly runs counter to the need for more highly trained or versatile labour that can meet the high quality standards demanded. Consequently, use is also made of other means of achieving greater flexibility, such as the elimination of restrictions on the introduction of organizational innovations: work groups, just-in-time production, etc. (Monza, 1994). This internal or technological flexibility is another aspect that strengthens the trend towards greater flexibility of systems of remuneration.

The importance of the question of labour costs has also varied as a result of the series of changes that are taking place in production and in systems of remuneration. To begin with, successive changes in technology and in the organization of production seem to have reduced the relative weight of labour costs, since in various sectors they now account for a smaller share of total production costs. Secondly, the structure of labour costs has been changing because companies have tended to increase their use of indirect forms of remuneration. Thirdly, the combination of a basic wage with a variable remuneration component is considered to be a promising means of bringing flexibility into the system of payment. And finally, this last combination also opens up the possibility of incorporating motivational elements into the system of payment and increasing its attractiveness in terms of recruiting and retaining skilled workers.

As regards the weight of labour costs in total costs, changes in forms of production have reduced the relatively high percentage that previously corresponded to labour (especially unskilled labour). This effect is most clearly seen in the industrialized countries: in the Japanese electronics industry, for example, the labour component is now only 5 or 10% of total costs. The changes in this respect do not seem to be limited to high-technology sectors, however. Changes in the cost structure due to the application of new technologies have also affected traditionally labour-intensive industries such as textiles, even swinging the balance back in favour of the industrialized countries in some cases. An example is that of Benetton, in the garment industry: unlike its rivals, who have transferred their production activities to Asia, this firm manufactures 80% of its products in Europe (*The Economist*, 1994). This is because changes in technology have permitted Benetton to

³ While the costs connected with certain regulations can be measured exactly (in Brazil, for example, employers' contributions are equivalent to 35% of net remuneration), provisions for outlays such as labour accidents or seniority are not so exact, as they depend on whether events actually occur or on the staff structure of each firm. The estimates of these provisions are based on certain hypotheses which introduce a margin of error. With regard to staff seniority, for example, the study in question adopts the hypothesis of average seniority of 10 years. This means that in countries where the average seniority is less than this figure, the labour costs are over-estimated. For more details of the methodology used, see Bour, Susmel, Bagolini and Etchart, 1992, pp. 6-8 and tables 1-5.

change its structure of production to a capital-intensive one, which has allowed it to maintain its operations in a region of higher labour costs.

The burden of additional costs that have to be paid on top of the basic wage, such as various types of allowances, overtime, etc., differs between sectors and between firms. Generally speaking, it may be said that the weight of these costs in total labour

costs has increased for various reasons. In recent decades, the component of labour costs which has grown most in the industrialized countries has been the employers' contribution to social security systems, because of such changes as improvements in the benefits of those systems and the higher cost of pensions and medical attention (although recently this cost has stabilized).

VII

Wages systems and flexibility

The recent concern with making the system of remuneration more flexible has contributed to the adoption of indirect forms of payment and the incorporation of a variable component in wages. From the point of view of the enterprises, whatever their performance, the aim is usually to avoid systems of remuneration involving fixed payments to their workers. When wages represent a fixed cost, this means that in periods of poor business the employers have to resort to dismissals in order to reduce their costs, which is always a traumatic process. The introduction of a variable component makes possible endogenous adjustments which automatically reduce labour costs in times of crisis and thus make outright dismissals a last resort.

Although cost-related aspects are important, due attention has not been given, in the current debate on the need for greater wage flexibility in Latin America, to motivational aspects and the organizational changes which are necessary and desirable. The fundamental aim of introducing a variable component is to link remuneration immediately and directly to the actual performance of the worker or company, so that it becomes an incentive. In addition, however, material incentives linked to performance must also be designed to improve the company's performance in areas which are its responsibility. The various aspects that must be taken into account in designing such systems must be adapted to the characteristics of the company, so that it can achieve its strategic goals. The identification of such aspects is therefore a fundamental factor in the success of a given system.

Systems of remuneration which include a variable component may display very different characteristics in their various aspects (Belcher, 1991):

i) The unit whose performance is to be measured and remunerated may range from the individual worker to a group, section, factory or the enterprise as a whole; the choice will depend not only on practical aspects (difficulty of determining the productivity of some workers, for example) but also on the attitude that it is desired to promote (team work or individual activity).

ii) The nature of what is to be remunerated (such as output, quality, use of machinery, productivity, or a combination of these factors) may vary; care must be taken to ensure that the incentive created does not adversely affect other aspects (for example, there are incentives designed to raise productivity which may have unwanted side-effects such as deterioration in the quality of the final product or an increase in labour accidents).

iii) The starting level from which it is desired to improve performance can be fixed on the basis of technical measurements or of the levels attained in the past.

iv) The expected variable component of total wages must be set at a level which is high enough to form an incentive but not so high that the actual wages can fall considerably below the going rate.⁴

v) Finally, it will be necessary to select the periods over which the results are to be measured and remunerated, taking care that they are not so short that the corresponding administrative costs become

⁴ When there are suitable conditions for the successful application of such systems, the expected variable portion will represent between 25% and 30% of total wages. If such conditions are not present, then the variable portion will have to be smaller (ILO, 1985b).

too high, nor so long that they cause the workers to lose sight of the link between more diligent work and higher pay.

Those in favour of incorporating a variable component in wages claim that this option holds out benefits at the macroeconomic level in terms of employment and lower inflation. This makes these systems particularly attractive to governments. As far as employment is concerned, linking a substantial part of wages to company performance may stimulate new hirings, as it reduces the employers' risks by bringing in a variable element. With regard to inflation, linking wage increases to company profits or increased productivity reduces the wage-related causes of inflation. For the workers, the main benefit of these systems is that they may reduce dismissals when the company is passing through a bad spell, since the reduction in labour costs is endogenous. In periods of growth, in contrast, the workers will automatically share in the better results.

In spite of the advantages that these systems seem to offer, however, in practice they suffer from some limitations. At the macroeconomic level, the basic limitation is that these systems have only been adopted by a small number of firms, so that they have

not yet had a significant impact. Indeed, as they have to be centered on the specific characteristics and objectives of the firms involved, variable wage systems are basically a microeconomic instrument.

The problems encountered at this level are very varied. An example is that of Great Britain, where the government promoted the adoption of wage systems including a portion linked to company profits by offering tax rebates. The results observed are as follows:

i) the variable component generally takes the form of a bonus on top of the basic wage, and has ended up being used instead of annual wage increases;

ii) when the variable portion is not a significant part of total wages, it is not enough to compensate for high labour costs in times of recession, and therefore does not avoid dismissals;

iii) companies may find it difficult to retain their best workers in periods of depression when the non-payment of the variable portion may cause wages to drop below market levels; and

iv) the factor selected for fixing the variable component may be exposed to various influences which are beyond the control of the workers, thus breaking the link between their pay and the effort made by them (IDS, 1990 and 1992).

VIII

Qualitative and motivational aspects

All the above considerations are connected with the qualitative aspects of work, to which the system of remuneration should make a positive contribution. Thus, the wages policy of a firm should attract workers in the necessary numbers and quality, retain that labour force, and motivate it to improve the firm's performance. With regard to motivation, it should be emphasized above all that wages policy is only one of the instruments available for motivating workers, and in no sense can it take the place of other personnel policies.

Wages systems which include a variable component can help to raise the workers' degree of motivation, and are generally aimed at doing this. Among the arguments in their favour, it is claimed that these systems help the workers to identify more closely

with the firm and take an interest in its success, and they also make it possible to stimulate various forms of participation aimed at changing old forms of production, such as work in relatively small teams, improvements in quality, or the submission of specific proposals to save materials or reduce costs. These systems require smooth and effective communication between staff and management, both in their design and in their implementation. Lack of transparency in such communication may lead to the failure of the programme, while the existence of big fluctuations due to external factors outside the control of the staff may lead to disputes.

Finally, it should be emphasized that in the context of the present trend towards greater trade openness, the quality of labour occupies a leading place

which is not always recognized. At the international level, relative labour costs are an important factor, not only in themselves but also within the context of local productivity, the existing infrastructure, government policy, and the levels of education and training of the workers. Low labour

costs alone can only be a factor of comparative advantage in the short term. In order to attain long-term competitiveness, low costs must be accompanied by high quality. Countries where labour is cheap but its quality is low will be more vulnerable in the new international economic context.

IX

Conclusions: the need for a new balance

In the first part of this article it was noted that excessive intervention which gives priority to one objective but neglects the rest may impair the success of a system of remuneration. In the case of Latin America, we illustrated this by the example of a period of containment of wages, especially in terms of its effects on the structure and performance of public sector employment and on wage differentials. In practice, we have seen the limitations of some of the instruments used, while the passage of time has reduced the effectiveness of some means which could be useful over shorter periods. As an example of the former, we may mention the attempts made to apply partial indexing mechanisms or place limits on negotiated wage increases, while in the case of the latter we may note the incomes policies used during the application of non-traditional stabilization programmes.

At the present time, there is a trend to seek greater flexibility both at the level of the labour market in general and at the level of the company itself, frequently thanks to technological or operational changes. The adoption of some measures to promote greater flexibility may be valuable in certain circumstances, but this must not be seen as the only solution, nor must too much faith be placed in its capacity to solve very complex problems.

The formal introduction of measures to promote flexibility is not the only option, since even systems normally described as rigid can show some flexibility when necessary. An example of this is the case of Germany, whose wage system is often criticised for its rigidity. Nevertheless, the German trade unions agreed to wage adjustments below the level of inflation in the early 1980s, in 1989 and in 1993-1994. In addition, the industry-wide agreements are supplemented with arrange-

ments at the company level, thus providing possibilities of limiting total wage payments. In some industries, companies pay up to 30% over the agreed minimum. When these companies need to reduce their wage costs, they cut this extra payment while keeping total pay unchanged (as in the case of Bosch), or they keep the extra payment unchanged but reduce its weight as a percentage of the total (as in the case of Mercedes-Benz). Another example of flexibility is the recent Volkswagen agreement whereby working hours are cut and so are wages (UIMM, 1994).

Flexible wage systems have their limitations as means of attaining the multiple objectives assigned to them, however. It is important to note that these limitations affect both the objectives of governments and those of employers and workers.

With regard to the objectives of governments, variable wage systems cannot be expected to solve all employment problems and control inflation. It would be more realistic to see them as one contribution, among various other necessary measures, for providing relative relief in crisis situations at the enterprise level. Flexible wage systems should be viewed fundamentally as instruments which are useful at the microeconomic level but which have only marginal effects at the macroeconomic level.

On the enterprise side, this instrument must be used with caution, after clearly defining the strategic aspects that it is desired to promote and identifying the negative effects that its application could have. Moreover, as already mentioned with respect to Great Britain, companies which establish a variable portion of total wages often set it at quite a limited percentage of the latter, which means that it may not give the margin of flexibility that companies need when there is a drop in demand.

From the point of view of the workers, the most obvious attraction is that they can share to some extent in the company's profits at times of growth (profit sharing) or increase their income by making a greater effort (payment by results), as well as achieving more stable contractual relations. This is particularly so in the case of companies which are obliged to increase productivity and improve quality in order to compete at the international level; such firms have to invest in their human capital and will naturally be interested in reducing staff rotation. At times of crisis, however, these conditions may change.

Generally speaking, changes aimed at securing greater flexibility demand changes in behaviour and management. Forms of remuneration linked, among

other things, to output, productivity and the business results of the company should be complemented with more open and participative management structures which make them more acceptable and involve the workers themselves in the quest for improvements. It has been seen that the success of these systems depends largely on the way they are introduced (with or without the participation of the workers) and their subsequent implementation (forms of communication and follow-up of the business results of the firm). Obviously, this calls for more transparent and responsible forms of negotiation than in the past, when high and fluctuating rates of inflation led to frequent adjustments which had dubious real effect.

(Original: Spanish)

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Central America:

macroeconomic performance

and social financing

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The analysis of social area financing in small economies has taken on great importance in recent years with the growing recognition of the mutual links between economic and social processes. Investment in human capital is seen as fundamental for attaining the competitiveness demanded by participation in world trade. In Central America, the socio-political situation has given rise to growing interest in studying social area financing and in gaining a knowledge of the economic possibilities there will be in coming years for assigning resources to social activities. This article presents a methodological proposal for the analysis of social financing, whereby it is sought to identify the degree of feasibility of social programmes in the light of the macroeconomic environment, the fiscal context, and the domestic policies which determine the priorities that each country gives to action in the social field. It is concluded that significant advances will be needed in these fields in order to increase social financing in the subregion, so that the process will be a long one: there will be no appreciable results in the short term, because changing the conditioning factors will be an undertaking with a long lead time.

I

Introduction

The analysis of social area financing in small economies has taken on great importance in recent years with the growing awareness of the mutual linkages between economic and social processes. It is no longer considered conceivable that social development could take place in isolation from the process of structural adjustment and economic stabilization. On the contrary, the mutual relations between these two aspects of development have become increasingly clear.

An example of this is provided by the proposals on human development made by the United Nations Development Programme (UNDP). These proposals hold that the attainment of integral development demands a close relation between the expansion of production and the generation of opportunities for all sectors of the population to participate in that growth. It is likewise held that social expenditure is a powerful tool for endowing the under-privileged social sectors with their own capacity to succeed in a suitable growth context. The assignment of resources to the social area should not be interpreted as a mere redistributive process but as the basis for creating the human resources needed to sustain the material development of society (UNDP, 1991).

Likewise, in recent years international financial organizations such as the World Bank and the Inter-American Development Bank (IDB) have tried to launch a new concept of the development process, stressing that investment in people is fundamental for successful economic performance. It has been noted, in this respect, that the competitive advantages attained by the East Asian economies have been based, among other aspects, on the fact that suitable priority was given to public expenditure in the social sectors, especially investment in basic education and in the technical training of the population. These economies thus built up a store of human capital which enabled them to reach higher levels of productivity than other countries of a similar type, thus rapidly increasing their production while at the same time raising their levels of equity (Page, 1994; Leipziger and Thomas, 1994). It is therefore recognized now that financing the social area makes a substantial contribution to

economic growth itself, since it makes possible the investment in human capital which is essential for expanding the production of small economies in the globalized context of today's world.

This is now also recognized in Central America, in view of the socio-political situation of the subregion. The process of peace-building and democratization in Central America has led to the reorganization of societies which previously suffered from serious conflicts, and the reconstruction of political systems has made possible processes of dialogue which look beyond the mere solution of short-term problems. There is thus growing interest in questions of development and subregional integration, within quite a broad context of ideas and proposals for economic and social improvement.

The meetings of Central American Presidents in recent years have highlighted the concern to build up an economic growth model which fits in smoothly with social development needs, in order to provide a solid foundation for the new societies arising out of this process. Since the Esquipulas Declaration and the subsequent meetings of Presidents, the Central American agenda has been dominated by proposals for achieving sustainable economic and social development, in which integration plays an important role as a shared means of solving the problems standing in the way of that objective.

The political bodies responsible for coordinating the social area in each of the countries of the subregion have shown a growing desire to find out what the economic possibilities for assigning resources to social activities in the next few years are likely to be. This suggests that the study of social financing is of fundamental importance for guiding decisions on the process of allocating society's resources. This question must be placed in its proper perspective, however. Idealistic positions urging the adoption of social programmes without taking account of the constraints of the economic and fiscal environment usually lead to the formulation of plans which have no material base, thereby giving rise to frustration among the institutions and sectors of the population which it was desired to benefit when it becomes clear

that there are not enough resources to make those plans a reality. At the other extreme, there are pessimistic positions which give rise to a state of inertia: if the macroeconomic and fiscal situations are unfavourable, the factors in the economic environment are seen as utterly decisive and a mechanical attitude is adopted which rules out action in the social area.

These risks with regard to resource allocation must be avoided through a proper assessment of each

of the factors influencing the process of financing the social area. The method of analysing social financing proposed here seeks to help to identify the degree of feasibility of social programmes in the light of the real possibilities of the macroeconomic environment and the fiscal context and on the basis of the definition of domestic policies in each country which lay down the priority to be given to social activities within the overall actions of society.

II

A proposed method for studying social financing

Social financing forms part of the process of allocating the scarce resources of the economy to cover the various needs of society. Consequently, it cannot be considered in isolation from the aspects conditioning that process. Bearing this in mind, a more exhaustive analysis can be made of the real possibilities of attaining given levels of social financing in the particular conditions of each society. This approach makes it possible to improve on previous schemes which viewed social financing as the provision of resources for social activities as a function of an absolute priority, in view of their importance in the development process; such schemes do not permit of effective financing, however, when social resources have to be found in a situation of macroeconomic constraints which makes it necessary to know exactly what part of the overall economic space can be occupied by the social area.

This section presents a proposed method for studying social financing as part of a process of assignment of resources to specific sectors of State action, within the framework of the overall macroeconomic behaviour. This proposal concerns the following aspects that explain per capita social expenditure:

Per capita GDP	→	Public expen- diture/ GDP	→	Per capita public expen- diture	→	Social expenditure/ public expenditure	→	Per capita social expen- diture
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In the proposed method, the starting point for the allocation of resources is the size of the economy, as measured by its annual gross domestic product, and

the size of the population, which, taken together, indicate the capacity of the society in question to satisfy the needs of each of its members. In our proposed method, therefore, the process of analysis will start with the per capita gross domestic product, in order to establish the average income that can be assigned to the members of the society. This is a crucial point in studying the social financing possibilities of small economies, since the structural differences observed in this type of economy give rise to very marked differences in the per capita GDP. It is also necessary to assess the possibilities of increasing this GDP, in the face of the challenge of globalization, to levels which, though desirable, are not always within the reach of such economies. The combination of structural shortcomings and difficulties in participating successfully in international trade can stand in the way of expanding production to solve the existing income limitations. We can thus see that inequalities in production capacity and population represent material factors which affect social financing, even without taking account of the more specific factors governing the allocation of resources to this sector of State action.

Once the size of the economy has been defined, we must study the public sector's capacity to absorb resources. Growth of per capita GDP does not of itself guarantee greater assignment of resources to the public budget. In order to guarantee a certain level of financing of public activities, State mechanisms for the procurement of resources are needed. The first of these mechanisms is the tax system, which is defined

by the national political will to finance the public sector through various kinds of taxes. Another mechanism is the charges made by the State for various products or services, which can be a means of obtaining substantial resources where the public sector has significantly diversified its activities. Furthermore, small economies often have various forms of transfers of internally or externally generated resources from the non-governmental sector to the State. Finally, indebtedness with domestic or external sources of credit may be resorted to in order to expand the capacity for public spending.

The application of these mechanisms results in a certain level of total public expenditure, which defines the amount of resources available to the State for exercising its various functions. These mechanisms reflect a set of allocation decisions which reject alternative uses in favour of allocations for public functions. In this respect, an indicator can be defined which expresses the degree to which a society decides to give priority to its public sector by assigning it a given proportion of its annual product. This indicator is the ratio of total public expenditure to GDP (PE/GDP). This percentage defines the effort that a society makes to endow its public sector with a material base, with respect to each unit of product generated in the economy. Thus, in the methodology presented here, if the ratio PE/GDP is applied to the per capita GDP, this gives the total per capita public expenditure. This latter variable is the result of the growth capacity of the per capita GDP and the decisions regarding the allocation of resources to the public sector, as expressed by the ratio PE/GDP.

The allocation of resources to the public sector does not automatically guarantee social financing, however. In order for the sectors making up the social area to receive part of the total government resources, an explicit decision to give them part of those resources is needed. In other words, the resources obtained by the State must be allocated with a certain degree of preference for social activities. The priority given to social spending can be measured by the ratio of social spending to total public expenditure (SS/PE). The resulting percentage expresses the internal will of the public sector to favour social activities with a certain amount of resources per unit of total expenditure. This confirms that there is no reason to assume a direct response by social spending to changes in total expenditure. Indeed, there are situations where although there is an increase in public

resources, at the same time there is a deterioration in social spending, because it has been given less priority within overall public expenditure. Likewise, sometimes social spending remains unaffected or even increases, in spite of a decline in public expenditure, because of an improvement in the ratio SS/PE.

Thus, in the methodology set forth here, if the ratio SS/PE is applied to per capita expenditure, this gives the per capita social spending. This indicator is the most appropriate measure, at the aggregate level, of the social financing of an economy, as it describes the amount of social resources that it is possible to allocate to each inhabitant on average. This indicator can of course be broken down by social sectors, geographic regions or beneficiary groups. In order to facilitate the explanation, this type of disaggregation will not be dealt with here, but it may be noted that the conclusions obtained at the aggregate level are also applicable at more specific levels of State action.

Consequently, the per capita social spending is the product of various factors of different types. On the one hand, the growth of production and its relation to population dynamics establish the global capacity to generate resources. On the other hand, the mechanisms for procuring public resources define the possibilities of State financing on the basis of the global resources of the economy, for which purpose it is important to know the ratio PE/GDP, which expresses the State's capacity to procure resources. Finally, the priority given to social activities within the public sector, as measured by the ratio SS/PE, permits a given allocation of resources to the social sectors.

It is therefore not possible to define in advance automatic relations between the macroeconomic environment and the fiscal context on the one hand, and the behaviour of per capita social spending on the other. A strict study must be made of each particular situation in order to determine the behaviour of each of these factors and find out the correct order of causality in each case. In the following section, these assertions will be illustrated by application to the case of Central America.

It should be particularly noted that our proposed methodology does away with the dispersed use of indicators of the behaviour of social spending which is usually observed in diagnostic studies. Thus, for example, the ratio SS/PE and the indicator of per capita social spending are generally used in a given analysis separately and without defining the relation which exists between them. The ratio SS/GDP is used

in a similar manner, but as we have seen, this ratio is already contained in the analytical sequence extending from the per capita GDP to the per capita social spending, via the intermediate stages mentioned earlier. In short, rather than operating with a series of

dispersed indicators, this proposed method seeks to integrate them into a single analytical process in which each one contributes to the determination of the per capita social spending. Observing one of them in isolation limits the depth of the analysis.

III

Social financing in Central America

The method proposed here can be applied to the study of social financing in Central America. It is worth examining in detail the behaviour of the various aspects analysed, in order to gain a better understanding of the differences observed in the resources assigned to the social area in each of the countries of the subregion. The sequence followed in the analysis deals with the following aspects:

Economic growth context

Level of GDP

→ Per capita GDP

Size of population

Fiscal context

Tax income/GDP

Other income/GDP

→ Total expenditure/GDP

Indebtedness/GDP

Social spending

Social spending/total expenditure

→ Per capita social spending

(social priority)

The combination of these elements, in the above sequence, allows us to explain the behaviour of per capita social spending as a function of various types of factors.

1. The economic growth context

The per capita gross domestic product of the Central American economies displays substantial disparities (table 1). In the Guatemalan economy, which is the largest in absolute size and also has the largest population in Central America, the per capita GDP occupies a middle level among the values observed. The Nicaraguan economy, which is the smallest in absolute size but has quite a large population com-

TABLE 1

Central America: Per capita gross domestic product (1993 dollars)

	GDP (millions of dollars)	Population (thousand)	Per capita GDP (dollars)
Costa Rica	7 349	3 269	2 248
El Salvador	7 614	5 517	1 380
Guatemala	11 330	10 030	1 130
Honduras	3 375	5 336	633
Nicaragua	1 866	4 117	453
Panama	6 381	2 538	2 514

Source: CMCA, 1994; IDB, 1994. Data prepared by the author.

pared with the product generated, has the lowest per capita in the subregion. Panama and Costa Rica, for their part, which are of fairly substantial absolute size in subregional terms but have relatively smaller populations, have a higher per capita GDP than the other economies, thanks to these two aspects.

We can thus see that there are many possible combinations of GDP and population size. There are three groups as regards per capita GDP. Panama and Costa Rica are at the highest level, with over US\$2 200 per inhabitant (at 1993 prices), thanks to the fact that they are the countries with the smallest populations but a substantial GDP in absolute terms. El Salvador and Guatemala occupy an intermediate position, with a per capita GDP of between US\$1 100 and US\$1 400, which is strongly influenced by the size of their population. Finally, Honduras and Nicaragua have the lowest per capita GDP in the subregion, because of the combination of quite low levels of production and populations which are quite large compared with the possibilities offered by the production environment.

Consequently, the material base for the procurement of public resources differs in the groups of

countries in question, and this naturally affects their possibilities of assigning resources to the social area. In other words, as there are different levels of per capita GDP, differences are also to be expected in the levels of public expenditure and social spending. Nevertheless, there could be counter-tendencies which could vary this general assertion in some way, depending on the interventions in the fiscal context and the priority given to the social area.

2. The fiscal context

The second aspect of our analysis concerns the situation of the public finances. Information on public expenditure as a proportion of GDP (table 2) reveals substantial differences in the relative levels of public expenditure among the countries of the subregion. Panama and Costa Rica are the countries where public expenditure has the greatest relative weight in the economy, attaining levels close to 50% of GDP. In the rest of the Central American countries, the figure is between 10% and 30% of GDP. El Salvador and Guatemala have the lowest relative levels of public expenditure: a little over 15% in the first-named and nearly 10% in the latter. Consequently, these two groups of countries are very different as regards the relative size of their public sectors. If, moreover, we recall that the per capita GDP of Panama and Costa Rica is twice that of El Salvador and Guatemala, this is a further reason why there are substantial differences in the relative size of the public sector. In other words, the amount of public resources per inhabitant is much smaller in El Salvador and Guatemala because not only is the weight of the public sector in the GDP relatively smaller, but also the per capita GDP is much lower.

TABLE 2
**Central America: Public expenditure
as a percentage of GDP, 1989-1993**
(Percentages)

Costa Rica ^a	51.47
El Salvador ^a	15.96
Guatemala ^b	10.76
Honduras ^b	23.19
Nicaragua ^b	28.91
Panama ^a	50.18 ^c

Source: CMCA, 1994. Data prepared by the author.

^a Non-financial public sector.

^b Central Government.

^c Estimate for 1989.

In Nicaragua and Honduras, the relative weight of the public sector is greater than in El Salvador and Guatemala. This means that they are able to make up to some extent for the fact that their per capita GDP is lower than in the latter two countries: because of the greater capacity to procure public resources, the size of their public sector is relatively closer to that of Guatemala and El Salvador.

If we look at the subregion as a whole, however, we see that all four of these countries are behind Panama and Costa Rica in terms of per capita public expenditure. As already noted, this is due to differences in both GDP and in the relative size of the public sector.

At this level in the analysis, it is important to determine the causes of the differences in public expenditure as a proportion of GDP among the countries of the subregion. These causes lie in the mechanisms used by each country's public sector to obtain resources. If we look at the sources of public income, in terms of GDP (table 3), we see that these countries display different capacities to procure tax revenue. Costa Rica registers the highest tax revenue as a proportion of GDP. No information was available for Panama, but it may be assumed that the tax situation there is similar to that of Costa Rica. The other economies display lower levels of procurement of tax revenue, although the figures for Nicaragua and Honduras are higher than for the remaining two countries, which partly explains the differences in public expenditure mentioned earlier. It is interesting to note, however, that regardless of these inequalities, in all the countries of the subregion the tax structure is based mainly on indirect taxes, which suggests generalized shortcomings in their tax systems.

In Costa Rica, there are additional sources of income which supplement the financing of public expenditure (it may be assumed that the same is true of Panama). This indicates that the diversification of public activities through the quasi-autonomous sector allows extra income to be obtained in respect of the provision of services. The comparison with El Salvador is of significant interest, as information is available on the latter country's non-financial public sector. In this case, there is a marked difference with Costa Rica in the item "Other income as a proportion of GDP", which reflects relative differences in the level of State development. Nicaragua has managed to obtain appreciable amounts of transfers from abroad in order to maintain a certain level of expen-

TABLE 3

**Central America: Public revenue, by source,
as a proportion of GDP, 1989-1993**
(Percentages)

	Tax revenue			Other income	Indebtedness		
	Direct	Indirect	Total		Domestic	External	Total
Costa Rica ^a	9.00	12.83	21.82	30.43	-1.45 ^b	0.67	-0.78 ^b
El Salvador ^a	2.44	6.04	8.48	4.95	0.52	2.02	2.53
Guatemala ^c	1.93	5.66	7.59	1.86	0.99	0.31	1.31
Honduras ^c	3.98	10.73	14.71	2.26	1.36	4.87	6.22
Nicaragua ^c	3.23	13.81	17.04	7.56	-0.18 ^b	4.50	4.32
Panama

Source: CMCA, 1994. Data prepared by the author.

^a Non-financial public sector.

^b Minus sign indicates a surplus.

^c Central Government.

diture, which explains why the item "Other income" is of substantial importance and also explains part of the difference in the relative size of its public sector compared with El Salvador and Guatemala.

Finally, as may be seen from table 3, fiscal control policies have done away with indebtedness as a means of expanding the public sector in most of the economies of the subregion. The period covered by the table (1989-1993) reflects the effects of the fiscal policies applied: in Costa Rica, El Salvador, Guatemala and Panama the levels of indebtedness are low in terms of the GDP, and in Costa Rica and Nicaragua there is even a domestic surplus. In Honduras and Nicaragua, however, there is appreciable external indebtedness which helps to keep up a relatively higher level of expenditure and explains part of the relative differences in expenditure with El Salvador and Guatemala.

3. Social priority and the relative level of social expenditure

The last step in the proposed analysis consists of studying the level of priority given to the social area in the allocation of public resources. In order to carry out this final step, we need to analyse social spending as a proportion of total public expenditure (table 4). The differences observed among the countries in this respect are not very large, with the values ranging from 34% to 39%. The values for Costa Rica and Panama might seem rather low, but their difficulties in formulating clear social policies in the 1980s may have affected the behaviour of this indicator. In Nica-

ragua, an effort has been made to give priority to the social area for the last decade and a half, and this is reflected in the bigger share of the social sectors in the allocation of public resources. In the remaining countries, the degree of priority given to social matters has fluctuated without any clear pattern, revealing the lack of a consistent social policy.

All this suggests that greater priority could be given to the social area in the countries of the subregion provided there was the capacity to apply social policies in keeping with the needs of each society.

TABLE 4

**Central America: Social spending as a
proportion of public expenditure in 1989-1993
and per capita social spending in 1992-1993**
(Percentages and U.S. dollars)

	Social spending/ public expenditure (percentages)	Social spending per capita (dollars)
Costa Rica ^a	39.07	420 ^b
El Salvador ^a	32.23	79 ^c
Guatemala ^d	39.40	48 ^c
Honduras ^d	34.01	56 ^b
Nicaragua ^d	36.21	44 ^c
Panama ^a	36.85 ^c	502 ^c

Source: CMCA, 1994; CRAS/UNICEF, 1994. Data prepared by the author.

^a Non-financial public sector.

^b 1992.

^c 1993.

^d Central Government.

^e Estimate for 1989.

When there are no marked differences in the priority given to social matters, the per capita social expenditure is determined mainly by the other aspects analysed: the evolution of the GDP and the fiscal situation.

If we look at per capita social spending in Central America in 1992-1993 (table 4), we see that in Panama and Costa Rica, because of the level of the per capita GDP and the relative size of the public sector, the level of this spending is over US\$400, which is quite high for the conditions of the subregion, but in the other economies of the subregion it is less than US\$80, as a result of the combined effect of the per capita GDP and the relative size of the public sector in each country, along with minor differences in the priority given to the social area. El Salvador

has a better level of per capita social spending because of its per capita GDP, but the effect of the latter is limited by the relative size of its public sector. Guatemala, which has a similar level of per capita GDP, does not register a similar level of social spending because its public sector is even smaller and it also has difficulties in giving greater priority to social matters on a sustained basis. Honduras and Nicaragua suffer from the effects of having very low levels of GDP, and although their public sectors are a little larger in relative terms it is not clear that they can keep up their level of public spending, because as already noted, part of that level has been achieved thanks to transfers from abroad or external indebtedness.

IV

Conclusions

There has been an intensive debate on improving social financing in Central America in recent years, because of the changes in the political agenda. The real possibilities of achieving such an objective have not always been studied in depth, however. In the preceding pages we have described the aspects of a global nature that condition the process of allocation of resources to the social area in Central America, with the aim of providing some background material that will help to identify the basic features of the process and to set a realistic course for the years to come. From the information presented, it may be seen that it is not possible to make generalizations, and much less to pretend that the levels of social financing of the different countries can be brought in line with each other in the short term. Consequently, the process of integration on the social level must take account of these differences from the start and design programmes of action which fit in with that situation.

According to the methodology set forth in this article, the possibilities of improving the allocation of resources for social activities in each country depend on three basic factors: i) the future outlook as regards growth of GDP and of the population; ii) the expansion of the relative size of the State, within a context of fiscal stability (proportional growth of public expenditure on a sound financial basis); and iii) higher priority for social matters when allocating public resources.

The prospects for growth of the product in the subregion in the next few years are not very clear. There is significant potential for economic expansion on the basis of export promotion, but in order to bring this about it will be necessary to make suitable definitions of, among other aspects, the form that increased trade openness will take (in view of the imbalances among the parties), the process of retooling a production apparatus which is rather obsolescent, the modernization of the production support infrastructure (transport, energy, communications, etc.), and the technical training of the labour force.

Most of the Central American economies have entered in the 1990s into an economic reactivation process which has been reflected in positive per capita GDP growth rates (table 5). This is not enough, however, to prove that they have successfully completed the economic changes needed to guarantee sustained growth. A suitable response is also needed at the demographic level. In several of these countries—mainly those that most need to raise their per capita GDP—population growth absorbs much of the growth in the product, thus limiting any increase in that indicator. Consequently, if it is desired to expand the material base for social financing it will be necessary to attain both a substantial growth rate of the product and a rate of population increase which permits a steady rise in the per capita GDP.

TABLE 5

Central America: Per capita GDP, 1989-1993
(Annual growth rates)

	1989	1990	1991	1992	1993
Costa Rica					
GDP	5.67	3.56	2.26	7.29	5.49
Population	2.78	2.67	2.57	2.51	2.44
Per capita GDP	2.81	0.86	-0.30	4.67	2.98
El Salvador					
GDP	1.06	3.40	3.53	5.14	4.98
Population	1.91	1.99	2.07	2.22	2.24
Per capita GDP	-0.84	1.38	1.43	2.86	2.68
Guatemala					
GDP	3.94	3.10	3.66	4.78	4.00
Population	2.93	2.93	2.94	2.83	2.94
Per capita GDP	0.98	0.16	0.71	1.80	1.04
Honduras					
GDP	4.33	0.10	3.25	5.62	3.66
Population	3.09	3.06	3.05	3.02	3.01
Per capita GDP	1.20	-2.88	0.19	2.52	0.63
Nicaragua					
GDP	-1.70	-0.13	-0.16	0.36	-0.88
Population	2.68	3.06	3.59	3.91	4.04
Per capita GDP	-4.26	-3.09	-3.62	-3.42	-4.73
Panama					
GDP	-0.26	4.88	8.89	8.45	6.28
Population	2.00	2.00	1.92	1.92	1.89
Per capita GDP	-2.21	2.82	6.84	6.40	4.31

Source: CMCA, 1994; IDB, 1994.

If it is desired to increase social financing, expansion of the relative size of public expenditure appears to be an unavoidable condition for most of the countries of the subregion. This conclusion is not at variance with the policies currently being applied all over Latin America and the Caribbean with regard to modernization of the State and fiscal discipline. What is needed is to accept that in many of the Central American economies the proportion accounted for by public expenditure is very low, because of a long-standing history of economic and social backwardness. Consequently, it is necessary to increase this proportion, but without losing fiscal stability, which means that considerable improvements must be made in the mechanisms for procuring public resources.

In order to do this, it is necessary to broaden the radius of action of tax systems, especially through progressive mechanisms, and to diversify the sources of income by greater decentralization of State acti-

vities. Foreign cooperation will have a very important role to play as a factor supplementing domestic financing efforts and as a support for achieving results in the short and medium term.

A significant role will also need to be played by the assignment of higher priority to the social area in the next few years, if it is desired to expand social financing. The average growth rate of the economy and the raising of the relative rate of public expenditure will not be enough on their own to ensure an increase in the allocation of resources to the social area. It will also be necessary to adopt an explicit policy of giving priority support to this area so that it can share in the fruits of those processes in order to finance the social sectors.

It will probably be necessary to make progress in all these fields, and not just in some of them, in order to increase social financing in the subregion, in view of the size of the shortcomings in this field. This

shows that the expansion of the resources destined for the social area will be a long process, since these factors will only bear fruit when they reach maturity. It is therefore essential that there should be the necessary national will to take the corresponding decisions and ensure the continuity of the policies adopted.

At the same time, in the economies of the subregion which have attained the highest levels of social financing, it is particularly important to carefully evaluate the efficiency and efficacy of public expenditure. Those countries where per capita social spending has reached higher levels must make every effort to see whether they could obtain better results with the existing resources. The growth in expendi-

ture has very likely been accompanied by declines in its productivity, so that in order to improve the allocation of resources to social matters it is necessary not only to increase the amount of those resources but also to raise their yield. To this end, measures should be considered such as the redistribution of resources within institutions, among institutions, and among geographical regions, so as to gain the maximum benefit from human and material resources. This also applies to the other Central American economies, although to a lesser degree, since in their case the problem is rather the insufficiency of the absolute level of financing.

(Original: Spanish)

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Panama

and Central American

economic integration

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This article looks at the benefits that Panama could derive from its possible integration with the countries of the Central American Common Market (CACM). First of all, Panama's production structure is analysed in terms of the phenomenon known as the "Dutch disease": this reveals the de-industrializing effect that the booms in the services sector have had on the economy. An examination is then made of the advantages that Panama could derive from gradual integration with the CACM countries in terms of intra-industry exports, promotion of investments, competition and modernization of production, and it is asserted that these benefits do not exist, on a reciprocal basis, in a scheme based on unilateral trade openness. An examination is also made of the ways in which subregional integration could further a process of modernization of production which could offset the adverse effects of the Dutch disease. Finally, some econometric equations based on a gravity model are presented and a quantitative assessment is made of the appreciable improvement that Panama could secure in its trade balance with the CACM if it became a full member of that integration scheme.

I

Introduction

In October 1973, the Central American countries –Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and Panama– signed the Protocol to the General Treaty on Central American Economic Integration, thus updating the integration process to bring it in line with the new lines of national and international economic policy. This Protocol was signed in order to broaden the sectoral and institutional field of action of integration and reflect the political will of the Central American governments to strengthen the integration process. The fact that Panama signed that Protocol could be interpreted as a step towards its adherence to the Central American integration programme. Panama and the Central American Common Market –made up of the other five Central American countries– have been cultivating closer relations for several decades past. Examples of this are Panama's participation in such bodies as the Central American

Institute of Public Administration and the Institute of Nutrition for Central America and Panama; its accession to the Central American Parliament in August 1994; its attendance at Presidential and Ministerial meetings in the subregion since 1990, and the increase in its trade with the CACM countries. All this, however, has not culminated in its definitive incorporation into the Central American integration programme.¹

In order to see what benefits Panama could obtain from its integration with the CACM, an examination will be made below of some distinctive features of the Panamanian economy and the areas in which integration could have favourable repercussions, and a quantitative assessment is made of the effect that a regime of free trade with the CACM would have on the Panamanian external sector.

II

The Panamanian economy

The economic structure of Panama reflects the big share accounted for by the services sector in its gross domestic product (approximately 80% in the early 1990s). This trend has been growing more pronounced in recent years, especially in transport, storage and communications, while the shares of agriculture and industry have gone down (table 1 and figure 1).

The share of investment in the GDP has also declined. Public investment has been going down steadily since 1976, and in 1992 it amounted to only a quarter of that year's level. Private investment also shrank between 1974 and 1991, and the recovery

registered in 1992 only managed to bring it back up to a figure below the levels of the early 1970s. The share of private investment in construction, machinery and equipment and transport equipment, as a proportion of GDP, showed a downward trend since the beginning of the 1970s, but recovered somewhat in the 1990s (figures 2, 3 and 4).

It is worth noting that investment in machinery and equipment has been identified as the type of investment that has the biggest impact on economic growth, generates substantial benefits through externalities (De Long and Summers, 1991) and has a

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¹ For an overview of the studies on Panama's relations with the CACM with regard to economic integration, see Thoumi (1994). See also Salazar-Xirinachs (1990); Lachman, Olaso and Vallarino (1991), and Lachman, Chocano, Figge and González (1992).

TABLE 1

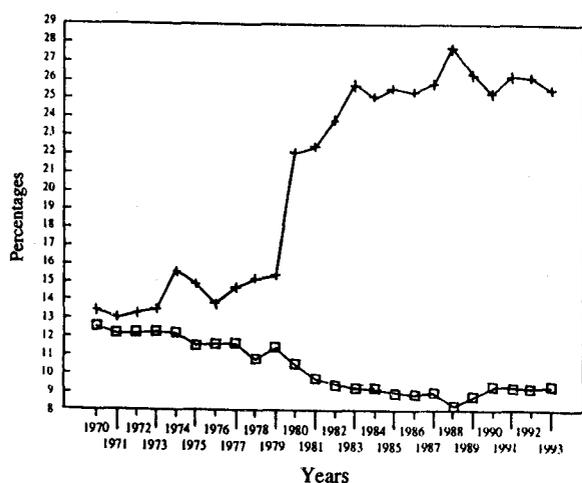
Panama: Structure of GDP
(Percentages)

Sector	1970	1975	1980	1985	1990	1993
Agriculture	9.55	7.80	6.07	6.11	6.90	5.52
Manufacturing	12.53	11.50	10.49	8.96	9.30	9.29
Commerce	15.84	14.34	14.77	12.57	11.69	11.87
Transport, storage and communications	6.02	9.08	22.08	25.62	25.30	25.47
Colón Free Zone	2.15	2.35	4.79	3.20	5.54	8.61
Financial institutions, insurance and business services	12.01	13.99	13.08	14.16	14.22	14.87

Source: *Estadística Panameña*, Dirección de Estadística y Censo de la Contraloría General de la República de Panamá (various issues).

FIGURE 1

Panama: Shares of transport, storage and communications sector and of manufacturing in the GDP



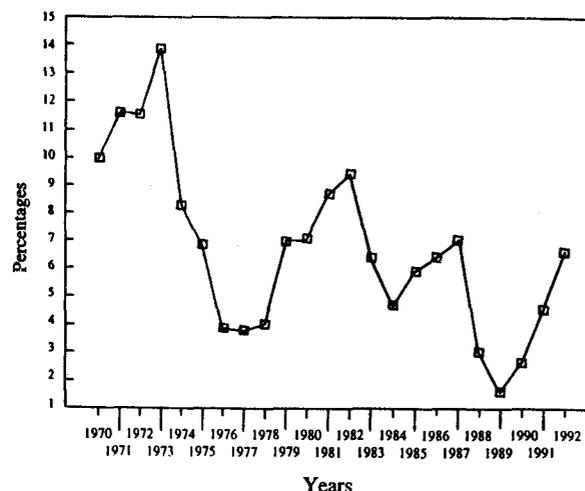
+ Transport, storage and communications
□ Manufacturing

Source: *Estadística Panameña*, Dirección de Estadística y Censo de la Contraloría General de la República de Panamá (various issues).

higher rate of social profitability than its private yield, so that policies which encourage it to rise to levels higher than the corresponding laissez-faire values help to speed up economic growth (De Long and Summers, 1992). Likewise, high prices of investment in machinery and equipment have a negative impact on growth, so that its promotion through tax policy helps to raise the economic growth rate (Jones, 1994). Other authors have found empirical evidence that investment in fixed capital, as well as

FIGURE 2

Panama: Share of private investment in construction in the GDP



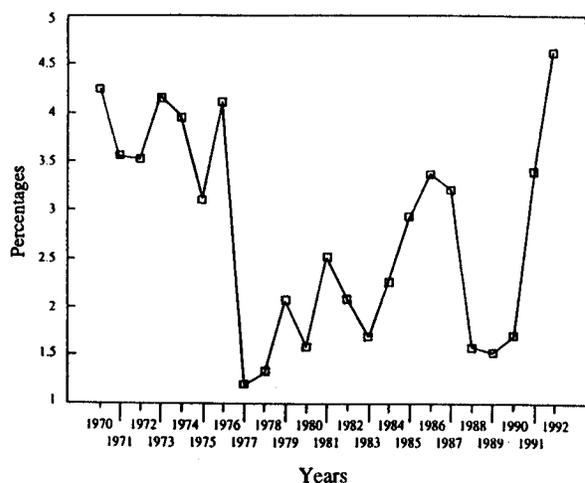
Source: *Estadística Panameña*, Dirección de Estadística y Censo de la Contraloría General de la República de Panamá (various issues).

expenditure on research and development, have effects that are just as significant as those of relative prices, or even more so, on the competitiveness of exports (Magnier and Toujas-Bernate, 1994).

The share of exports in GDP showed an upward trend between 1970 and 1980, rising from 38% to 44.03%, but this share fell back to 35% in 1992. The share of imports also grew between 1970 and 1980 (from 41.33% to 47.35%), but it too went down to 36.36% in 1992.

FIGURE 3

Panama: Share of private investment in machinery and equipment in the GDP

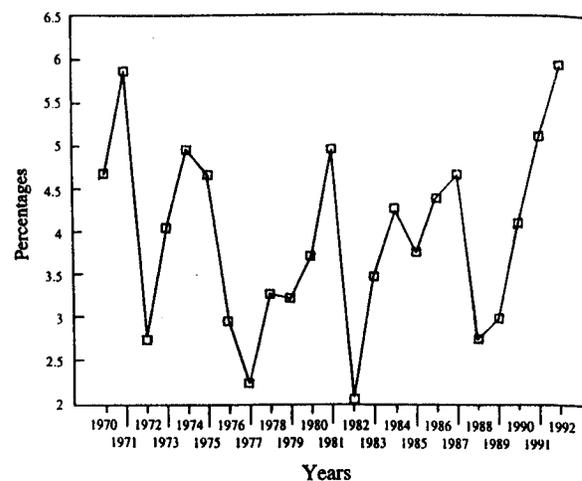


Source: *Estadística Panameña*, Dirección de Estadística y Censo de la Contraloría General de la República de Panamá (various issues).

Panama's economic structure may be explained as the result of a process called the "Dutch disease" in the economic literature.² This refers to the de-industrializing, and in some cases anti-agriculture, effect that an export boom has on the domestic economy. In the case of Panama, it is necessary to take into account the role played by the Canal Zone and,

FIGURE 4

Panama: Share of private investment in transport equipment in the GDP



Source: *Estadística Panameña*, Dirección de Estadística y Censo de la Contraloría General de la República de Panamá (various issues).

more recently, the Colón Free Zone, which have given rise to substantial increases in income. Thus, in 1988-1990 goods accounted for only 22.7% of total exports of goods and services, whereas the transport sector accounted for 34.8%, of which 19.7% came from Canal tolls. The Colón Free Zone, for its part, accounted for 18.1% of total exports.

III

The export boom and the Panamanian economy

In order to illustrate the process of de-industrialization which has taken place in Panama, a model is presented here which divides the economy into three sectors: the booming sector (A), which may be equated with the activities in the Canal Zone or the Colón Free Zone; the lagging industrial or agricultural sector (R), and the non-tradeable goods or services sector (N). In each of these, production is determined by the capital, natural resources and labour factors. The last-

named factor is movable, seeking to match the wages paid in the three sectors in question.

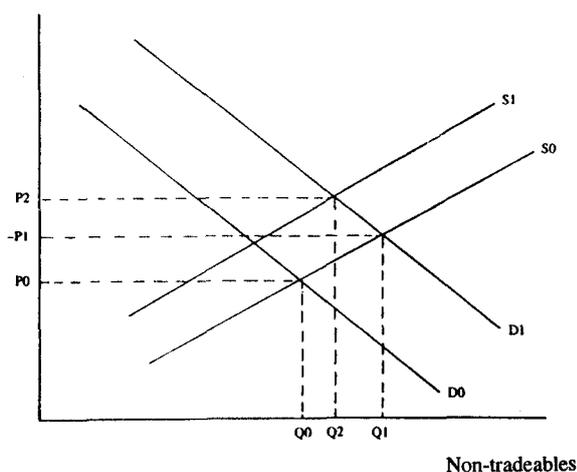
Let us suppose that the boom in sector A raises the incomes of those representing the factors used in it, and this in turn has two other effects: the expenditure effect and the resource transfer effect (Corden, 1984). On the side of the expenditure effect, as a result of the boom in sector A demand is stimulated in the services sector, N, so that prices rise, the production of non-tradeable goods is encouraged, and labour is attracted from sectors A and R, thus reducing the production of sector R. This can be seen from figure 5, where the vertical axis shows the relative

² See Gregory, 1976; Corden and Neary, 1982; Corden, 1984; Enders and Herberg, 1983. For a summary of the experience of several developing countries, see Cuddington, 1989.

FIGURE 5

Panama: Graphic representation of the effects of the "Dutch Disease"

Prices of non-tradeables
in relation to
tradeables



Source: Prepared by the author.

price of a non-tradeable compared with a tradeable, while the horizontal axis shows the output of services. The supply curve is derived from the transformation function between N and the two tradeable goods sectors. The demand curve shows the demand for services at their different prices. The income effect displaces the demand curve from D_0 to D_1 , which increases the consumption of services from Q_0 to Q_1 and the price of services from P_0 to P_1 . The rise in the price of services attracts labour from the lagging sector and reduces the production of sector R .

The resource transfer effect is due to the increased demand for labour in A , which causes labour to move to it from R and N . The outflow of labour from sector R causes a further reduction in the output of that sector, which is termed "direct de-industrialization". In turn, the movement of labour from the services sector to A generates an excessive demand for services, which is represented in figure 5 by the movement of the supply curve from S_0 to S_1 . This increase in demand gives rise to a fresh increase in the price of services from P_1 to P_2 , and this in turn causes an additional outflow of labour from the lagging sector to the services sector, thus accentuating the contraction of the former. The combination of the expenditure effect with the effect of the transfer of labour from R to N causes what is called "indirect

de-industrialization", which is added to the direct de-industrialization caused by the movement of labour from the lagging to the booming sector.

At the same time, the profitability of sectors A and N increases because of the rise in production, while it goes down in the case of sector R . The lower profitability of the lagging sector discourages investment in it, which is attracted instead to sector N .

In the model, it is considered that both agricultural and industrial production go down even in conditions of unemployment, if it is assumed that the movement of labour primarily affects skilled workers. If it is assumed that the booming sector does not attract labour from the other sectors, then the resource transfer effect would not occur. The expenditure effect *would* occur, however, as a result of the increase in the prices of N , thus causing revaluation of the real exchange rate and a consequent reduction of R . In this case, the expenditure effect could also take place through increased public sector consumption due to possibly greater fiscal revenue thanks to the boom in A .

It should be noted that expectations that the economic boom would continue could give rise to a tendency to spend beyond the means of the economy. This would not only accentuate the contraction of the industrial and agricultural sectors but could also create a chronic situation of low rates of saving, current account deficits, and external indebtedness.

Although the "Dutch Disease" model does not analyse the repercussions on the demand for and supply of credit, the increased demand for the goods of sector N could raise the demand for credit to finance that sector's production. Thus, the financing that might have gone to sector R would be displaced to sector N , and this would further accentuate the former's contraction. In Panama, credit to the agricultural and industrial sectors represents 4% of the total (Loehr, 1991).

Furthermore, in view of the tendency towards contraction the lagging sector might demand protection, to which end a number of measures to inhibit competition might be applied. Thus, in Panama there has been a rigid system of quotas, customs tariffs and support prices. This has been a factor in creating a situation in which the prices of some agricultural products are as much as three times higher than the Central American average (Loehr, 1991). Tariff protection for the manufacturing industry, weighted by production, has averaged 66.8%, but the effective level of protection has been much higher, since industrial

inputs have been exempt from customs duties. The fact is that Panama has higher and more dispersed customs tariffs than the CACM countries (Loehr, 1991), and according to Thoumi (1994) it has been one of the most protectionist countries in the whole continent.

This high level of protection could explain the concentrated structure of manufacturing, but on the other hand this structure could itself be responsible for the high protection, since it has been observed in various countries that the greater the concentration of industry, the more intensive are the campaigns for higher protection (Connolly and de Melo, 1994).

It should be noted, however, that Panama's export boom is not necessarily a negative factor. On the contrary, its good effects are reflected in the high per capita income levels, the level of social development, and the rates of growth attained. At the same time, however, in view of the progress being made all over the world in economic liberalization, the fact of remaining aloof from an important source of benefits deriving from industrial production could represent a high opportunity cost for the country. It should be noted that manufacturing has been recognized as a source of technological change which benefits the economy as a whole, specifically through reductions in costs, improvements in quality, and the acquisition of new skills. The expansion of the services sector, on the other hand, has been criticised because it does not make possible the cultural, technical and intellectual development that only a sound and vigorous manufacturing sector, and the urban development associated with it, can bring (Kaldor, 1981). It has also been noted that an economy accustomed to receiving

a steady inflow of rents runs the risk of being incapable of generating its own income when the source of those rents disappears (Ellman, 1981).

Furthermore, recent studies have shown that the expansion of the services sector does not generate economic growth (Dutt and Lee, 1993). In particular, Harry Johnson (1976) has expressed his pessimism about the effects of the financial sector on the Panamanian economy. This is why it is important to strengthen the country's productive sector and at the same time correct the constraints imposed by the Dutch Disease.

In other words, it would be desirable to put the Panamanian economy on a new track, both in order to help surmount the protectionism and stagnation of its productive sector and in order to take advantage of the benefits of competition and productivity. Panama should not remain aloof from the integration movements which have grown up in the subregion. These movements, based on open regionalism, seek to promote efficiency through subregional competition and coordination and are effective means of securing better linkages with the international economy (ECLAC, 1994; Fuentes, 1994).

For these reasons, if the country is to take full advantage of its geographical location it must take a number of measures to endow its production apparatus with competitiveness and innovative capacity. This modernization of the national economy would not only lead to a faster increase in productivity but also to the consolidation and expansion of Panama's role as an international centre. In the following paragraphs we will see whether integration with the CACM can be an effective means of furthering the modernization of the Panamanian economy.

IV

Would integration with the CACM bring benefits for Panama?

Subregional integration could complement the structural reforms needed in Panama and make them more sustainable, while at the same time contributing to the modernization of production, social progress and the development of the country's export sector.

It has been observed that trade among members of integration schemes is basically of an intra-industry nature (Balassa and Bauwens, 1987; Cáceres,

1994) and that this type of trade takes place because of the similar levels of per capita income and GDP of the member countries (Forster and Ballance, 1991; Greenaway, Hine and Milner, 1994). Similarly, according to customs union theory, the more similar the member countries are, the greater will be the amount of new trade created in an integration scheme (El-Agra, 1989), and the same will be true if the coun-

tries already have substantial trade relations (ECLAC, 1994). The integration scheme whose members have the levels of GDP most similar to those of Panama is the CACM, and several of its members already have substantial trade links with Panama. Consequently, if Panama linked up with the CACM this could be most beneficial in terms of the generation of trade.³

Integration with the CACM would also give Panama a broader market, which would not be the case if the country opted for unilateral trade liberalization.⁴ Specifically, the CACM would give Panama, under conditions of reciprocity, a market of 22 million people, which would facilitate its exports. This is of special importance in view of the high degree of variability of Panama's terms of trade (Leamer, Guerra, Kaufman and Segura, 1995): in order to stabilize this indicator, these authors recommend the export of manufactures, which would be made possible by the broader Central American market. The terms of trade would also improve because Panama could sell its products at "protected" prices by virtue of the common external tariff, whereas the countries exporting to the CACM and to Panama would be obliged to lower their prices in order to remain competitive.⁵

Within the CACM, the expansion of the market through integration gave rise to increases in private investment (Cline, 1978). Indeed, the recent reformulation of the theory of the "Big Push" within a context of imperfect competition (Murphy, Sheleifer and Vishny, 1989) holds that simultaneous investments in different sectors of a country generate reciprocal markets by simultaneously increasing demand for products by those sectors, so that companies can make profits that

³ Forster and Ballance (1991) note that the magnitude of specialization and intra-industry trade tends to be greater among countries which are of similar size or income levels. Furthermore, the higher the per capita income and the bigger the market, the greater will be the degree of intra-industry specialization for most industries. Cáceres (1994), for his part, gives an analysis of intra-industry trade flows in the case of Central American integration.

⁴ When considering a scheme of unilateral trade liberalization for Panama, it is worth bearing in mind the question posed by Dornbusch (1989): "...it has been suggested that Argentina should adopt a position of unilateral free trade. But what industry could survive under such a scheme, and would such a result come within the limits of the politically acceptable? If the answer is no, then a customs union could be a very important alternative for reducing the costs of protection".

⁵ Wonnacott and Wonnacott (1981) and Dornbusch (1989) analyse the question of the terms of trade in an economic integration scheme.

they would not achieve without this set of investments. This complementarity of effective demand, which is connected with market size, can be generated in a subregional setting through integration. Thus, the geographical proximity of Panama to the CACM countries would enable it to receive the spillover of investments from those countries and thus sustain an effective capital formation effort.

Furthermore, integration with the CACM would prepare Panama for possible future integration with more developed markets—for example, with that arising from the North American Free Trade Agreement (NAFTA)—and would serve as a learning mechanism for the development of competitive advantages which, with time, would allow it to successfully join other economic blocs.⁶

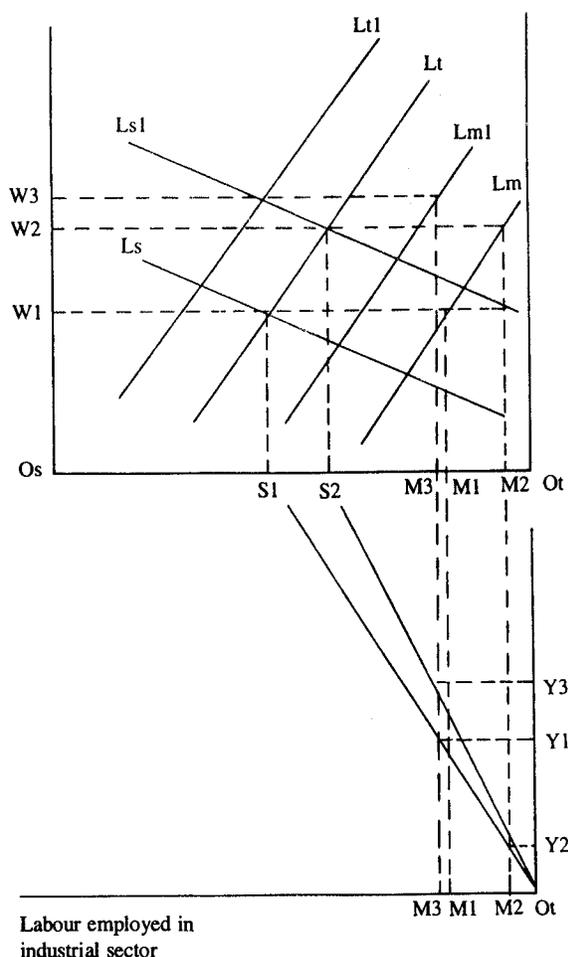
At the same time, broadening of the market would reduce national industrial concentration, since concentration of firms in the market at the Central American level would tend to prevail. This would facilitate exports, because of the inverse relation between industrial concentration and the price/cost spread (Sleuwaegen and Yamawaki, 1988; Forster and Ballance, 1991). Indeed, it has been suggested that economic integration has a stimulating effect, because greater competition gives rise to extra efforts on the part of companies and managers (Pelkmans, 1982), while at the same time integration reduces production costs and increases company productivity (Venables, 1994). In the case of Central America, integration has helped to bring down inflationary pressures through competition (Cáceres, 1978). Likewise, in the case of the EEC, calculations of the dynamic effects of integration in terms of greater efficiency, increased saving and economies of scale show that these benefits are of significant magnitude (Péres, 1993). All this shows that integration is an effective means of offsetting the tendencies towards stagnation associated with the Dutch Disease.

Figure 6 shows what integration can do to offset the harmful effects of this disease. In that figure, which for reasons of brevity shows only the functioning of the expenditure effect, labour market wages W are shown on the vertical axis and the labour supply $OsOt$ is shown on the horizontal axis. The labour input of the services sector is represented by the dis-

⁶ Cáceres (1993 and 1994) highlights the opportunity to prepare for a future good performance in integration schemes with more developed countries, pointing to the complementarity between subregional integration and subsequent global liberalization.

FIGURE 6

Panama: Expenditure effect and integration



Labour employed in industrial sector

Source: Prepared by the author.

tance from O_s , while that of the manufacturing sector corresponds to the distance from O_t . The lower quadrant contains the production function of the manufacturing sector, where production Y corresponds to different levels of labour. The curve Ls represents the demand for labour in the services sector, while Lm refers to the demand for labour in the industrial sector. The total of the demand for labour in the industrial sector and the demand for labour in the booming sector gives the total demand for labour of the export sector, Lt .

When we look at the income effect, we can see in the figure how the export boom gives rise to an increase in the consumption of services; this stimulates the demand of this sector for labour, which shifts the curve from Ls to Ls_1 . Balance is restored at a wage level W_2 . At this wage level, employment in services increases from S_1 to S_2 , while employment in

industry goes down from M_1 to M_2 , giving rise to a contraction in industrial production from Y_1 to Y_2 .

If the country joins the CACM, labour productivity in the industrial sector will rise. This increase in the marginal product of labour is represented in the figure by the shift of curve Lm to Lm_1 , which in turn causes curve Lt to shift to Lt_1 . The new balance is established at wage level W_3 , which causes a decline in employment in services and an increase in employment in industry, from M_2 to M_3 , as a result of which industrial production rises from Y_2 to Y_3 . We see, then, that integration has increased both industrial production and employment from Y_2 to Y_3 and from M_2 to M_3 , respectively, thus offsetting the effects of the Dutch Disease.

Furthermore, as an additional benefit, integration would give Panama a further incentive to maintain macroeconomic discipline, for economic liberalization in a multilateral (subregional) framework would be more effective than at the national level, because of the strict discipline and compliance demanded by the multilateral supervision (Wolf, 1986; Genberg and De Simone, 1993). Likewise, reforms in a subregional framework would generate greater credibility, which, together with sustainability, is one of the determining factors in the success of reform programmes (Rodrik, 1990 and 1991; Funke, 1993). Furthermore, it would facilitate Panama's access to the store of experience of the CACM countries on economic reform, as well as easing its participation in the effort to change production patterns. This could be easier for it because the other countries have already gone through this same process and because of the international support that the Central American integration programme has received. Panama's geographical proximity to the CACM countries would also stimulate its exports, for distance and transport costs have been identified as the factors which do most to inhibit intra-Latin American trade (Primo Braga, Safadi and Yeats, 1994). In addition, because of the boost it would give to exports, integration would be effective in mitigating the adverse effects of the structural adjustment process.⁷

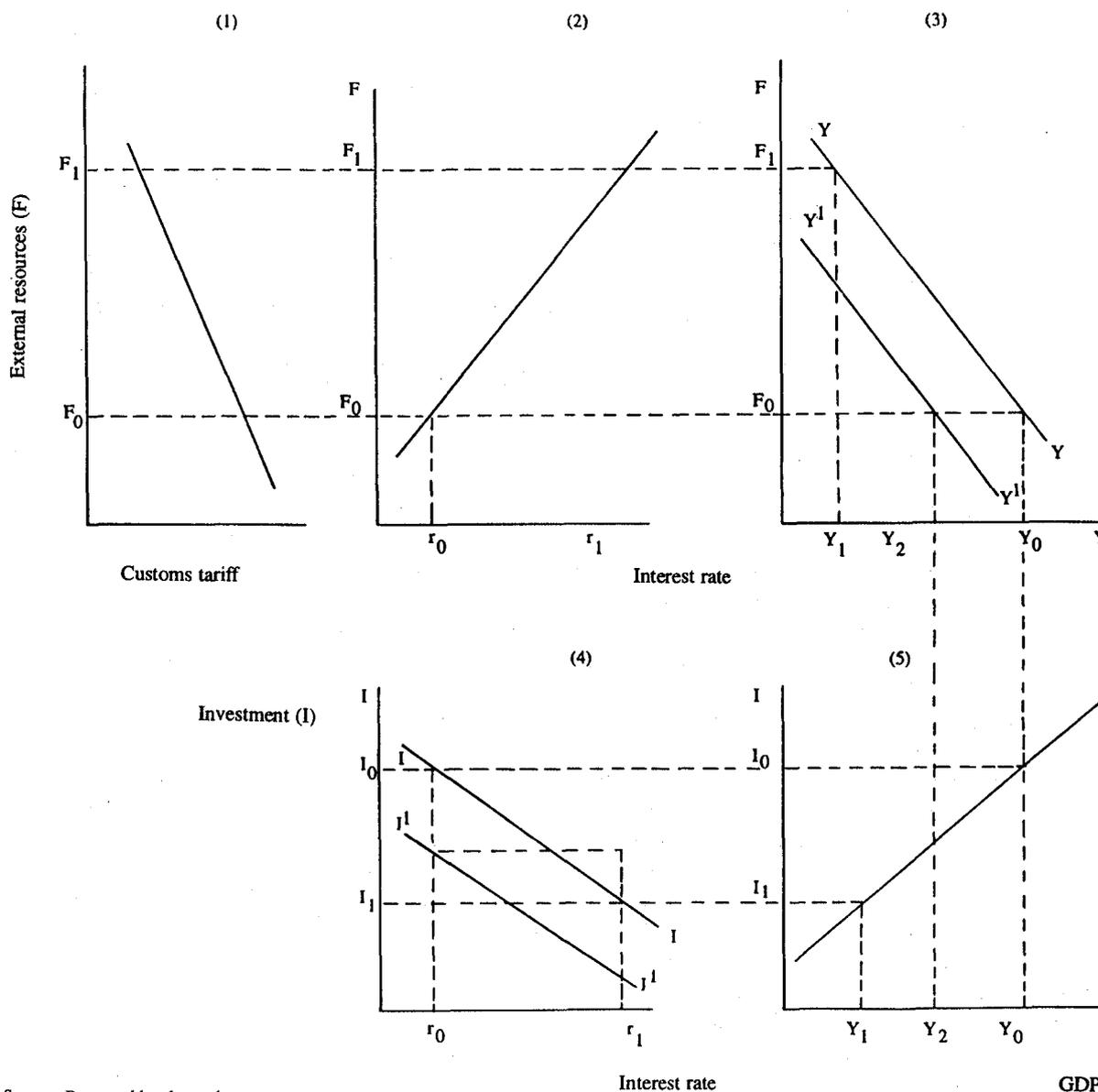
⁷ Greenaway and Hine (1991) argue that in the case of the EEC the economic adjustment costs have been reduced by trade integration. It may be noted that in El Salvador the Salvadorian Economic and Social Development Foundation (FUSADES, 1991) carried out a survey of 323 firms in November 1991, and their responses on the main benefits of Central American integration were as follows: more exports (21.1%); cheaper imports (53.9%); possibilities of investment in the subregion (17.0%); no benefits (15.2%), and miscellaneous other benefits (10.5%).

For Panama, economic integration with the CACM countries would be a "market swap" among countries with similar levels of development, and this, together with the common external tariff, would enable it to keep its trade account at manageable levels. This is a very different matter from unilateral liberalization, where the lack of reciprocity as regards tariff preferences and the imbalances with the rest of the world could lead

to a serious deterioration in the trade account. This is precisely what has happened in the region since 1989, when most of the trade liberalization programmes started (Gana, 1994). It should be noted that in order to finance the trade deficit it is possible that very high interest rates which would attract foreign capital might be needed, and this could tend to bring on contraction or stagnation of the economy (figure 7).

FIGURE 7

Panama: Customs tariff, external resources and GDP



Source: Prepared by the author.

Quadrant 1 of that figure shows the inverse relation between the trade deficit and the level of customs tariffs. Initially, in order to finance the trade deficit an inflow of external resources F_0 is required, which is obtained by offering an interest rate r_0 , as may be seen from quadrant 2. Quadrant 4 shows the level of investment I_0 corresponding to interest rate r_0 . This investment gives rise, through the multiplier, to a level of product Y_0 , which is shown in quadrant 5. It may be noted that when there is a tariff reduction, the resulting larger trade deficit will make necessary a larger inflow of external resources F_1 , which would be obtained at a higher interest rate r_1 and would lead to a lower rate of capital formation I_1 and a smaller product Y_1 . It may be seen from quadrant 3 that in these circumstances there is an inverse relation between the inflow of external resources and the gross domestic product, since the external resour-

ces are bolstering up an economy which is contracting and has a decreasing rate of capital formation. Furthermore, the greater need for external resources will be reflected in a growing external debt, which, coinciding with stagnating levels of GDP, could mean a deterioration in credit-worthiness. This process may be described as irreversible. This happens when, on restoring the trade deficit to its original value F_0 , it is not possible to recover the original value of the product Y_0 because the uncertainty caused by the recession has led to a structural change in the relation between investment and interest rates, so that, for a given interest rate, the rate of investment is less than it was before.⁸ This is shown, in quadrant 4, by the shift of curve II to II' . It may be seen that if the trade deficit is brought back to its value F_0 , the product would only recover to value Y_2 , which is less than the initial level Y_0 .

V

Towards a regional structural reform agenda within the framework of integration

Panama's integration with the CACM should be a gradual process which makes it possible to take advantage of benefits in certain areas while promoting a context of free trade in the medium term. This would mean establishing a generalized tariff reduction programme to be applied to a growing range of products. The present trade treaties between Panama and the CACM do not promote competition: on the contrary, as Thoumi (1994) points out, they are veritable instruments of protection due to collusion between producers on both sides, who share out the markets in accordance with their own regulations. This author also notes that this form of trade reflects exchanges among subsidiaries of transnational corporations on the basis of negotiated trade. This is why it would be desirable to progress gradually towards free trade with the CACM while establishing a level of protection against the rest of the world—until such time as the necessary reforms have been consolidated—which is lower than the present one. Without the minimum protection that needs to be applied against the developed countries, the resulting trade deficits would make it necessary to adopt high domestic interest

rates to attract foreign capital in order to help finance those deficits. The high cost of capital would lead to the stagnation of private investment and, ultimately, to loss of credibility of the macroeconomic reforms, thereby further accentuating the contraction.

Because of its excellent port facilities and its status as an important international financial centre, Panama has special advantages to offer in the services sector. Its integration with the CACM could therefore be based on this sector. However, the cost of Panama's sea transport facilities is extremely high, so that there would be little incentive for the CACM countries to use those facilities. Moreover, land transport in Panama is also more costly than in the other Central American countries and has a rigid oligopolistic structure (ROCAP, 1987). A joint programme of integration and deregulation of the services sector

⁸ Pyndyck and Solimano (1993) give an analysis of the negative impact that higher risk and lower credibility have on investment. The structural change that occurs as a result of the persistence of economic shocks is analysed in Cáceres (1985 and 1991).

could be organized in order to promote competition and make economic integration more feasible and fruitful. A priority measure in such a programme would be the implementation of national and subregional policies on competition.

The effort to bring about a structural change in the Panamanian economy cannot be restricted exclusively to policy reforms. It will also be necessary to take action in other fields, especially in export promotion, the dissemination and adaptation of technology, and the training of high-quality technicians and managers. Indeed, the impressive growth of the Asian developing countries has been based on the adoption of policies that strengthen the functioning of the State as well as the market, thereby making possible an economic and institutional framework which furthers equity and international competitiveness (Lim, 1994). The levels of protection applied in these economies have not been excessive, but have served to make up for the absence of market mechanisms in some cases and to improve their functioning in others. Transparent protection schemes have been established, human resources have been trained, support has been given to the development of new technologies, fiscal reforms have been applied, and market information has been provided. Furthermore, the coordination of private investment through subsidies has been carried out under the guidance of public-sector professionals of high technical calibre, thus ensuring the success of State action in this respect (Rodrik, 1995).

In view of the importance of making structural changes, it would be desirable for Panama, in conjunction with the CACM countries, to promote a subregional strategy for economic and social reform. Such a strategy could be carried out through joint efforts to facilitate intra-regional and international cooperation, exchanges of experience, and coordinated progress in national reforms to make the individual economies really capable of being integrated as well as bringing them closer to the possibility of integration with other regions. A relevant example is that of Chile, whose series of important economic reforms is generally recognized as an advance which will facilitate its integration with NAFTA (*The Economist*, 25 February-3 March 1995, p. 29).

Such a strategy would mean clearly identifying the objectives that each country wants to reach through integration and deciding on the reform measures that need to be applied in order to arrive at

a productive and social system in keeping with those of the subregion and of other schemes, such as NAFTA or the Andean Pact, for example. It would also mean differentiating between measures of national, subregional and international scope; establishing time schedules for each measure, differentiated by countries; and specifying the authorities responsible for carrying them out. The strategy could be formulated by the Central American Economic Cabinet, which could also be responsible for monitoring its execution. Within this framework, each country would identify the national scope of the reforms, programme the corresponding action, and make sure that they fitted in with the requirements at the subregional and international levels. The starting point could be the preparation of subregional-scope sectoral diagnostic studies which would make it possible to identify the reforms needed at the national level to meet given economic modernization objectives and goals within a framework of regional and international coordination. The measures resulting from the regional diagnostic studies would be applied at the national level according to what needed to be done in each country and the respective time schedule. In the execution of national reform measures emphasis would be placed on the elimination of obstacles to regional and international integration. This approach could also be useful for establishing a subregional dialogue with international sources of finance and technical cooperation, as well as with countries in other regions.

Likewise, when shaping this strategy the Central American countries could suggest to the NAFTA member countries that they participate as observers in the process of economic and social change, so as to establish an ongoing dialogue with a view to the future incorporation of Central America into that integration scheme. Such a multilateral framework for the reforms, with the participation of the NAFTA member countries, would give the process greater credibility. Furthermore, this joint dialogue would increase the bargaining power of the first-named countries and could help to make possible reforms of special importance in their economies.

The multilateral strategy would embrace economic reforms and especially social ones, so as to lay the foundations for a more equitable economy which would also help to consolidate the economic modernization process. In some countries, special emphasis would be placed on social development, in order to

correct long-standing shortcomings and promote the convergence of social indicators throughout the sub-region. In other words, emphasis would be placed on national integration.⁹ Within this framework, support

for the development of human capital is particularly important, since this resource is of decisive significance for the export of manufactures (Wood, 1994; Wood and Berge, 1994; Balassa and Bauwens, 1988).

VI

The increases that would be registered in Panama's exports and imports to and from the CACM if it were a member of that group

In order to estimate what Panama's performance within the CACM would be if it became a member, econometric gravity models were applied. In this kind of model, the trade between two countries is a direct function of their respective "economic masses" and the "distance friction" between them.¹⁰

In order to represent the "economic masses", the amounts of human capital in the exporting and importing countries (H_i and H_j , respectively) and their corresponding gross national products (Y_i and Y_j) were used. The "distance friction" affecting trade was represented by the distance in kilometres between the respective capital cities (D_{ij}).¹¹

As a first approach, a cross-section equation was estimated to explain intra-Central American exports,

excluding those of Panama. With the parameters of this equation, the values of Panama's exports to the CACM countries were then calculated. The exports thus calculated would reflect a situation in which Panama was a member of the CACM; the difference between these estimated exports and the real exports would correspond to the additional exports that Panama would make if it became a full member of the CACM.

The estimated equations for exports, E_{ij} , do not include Guatemala because no information was available on the human capital indexes of that country (table 2). It will be noted that both equations confirm that distance tends to reduce trade and that the elasticity of exports with respect to human capital is greater than their elasticity with respect to GDP.

TABLE 2

Central America, excluding Panama and Guatemala: Gravity model

Dependent variable	Independent variables ^a							
	C	H_i	H_j	Y_i	Y_j	D_{ij}	R^2	DW
(1) Log E_{ij}	-9.08 (1.45)	3.03 (2.90)	1.09 (1.05)			-1.04 (1.28)	0.53	2.30
(2) Log E_{ij}	-7.03 (1.61)			1.27 (4.25)	0.28 (0.94)	-0.42 (0.98)	0.44	2.09

Source: Prepared by the author.

^a Logarithms of the independent variables.

⁹ Ranis (1993) has given a very full description of the domestic requisites for regional economic integration. It may be recalled in this connection that in order to make possible the establishment of the Single Market in 1992, the EEC had already adopted a set of 282 measures as far back as 1985 (Pelkmans, 1991).

¹⁰ Markheim (1994) gives an assessment of the reliability of gravity models for estimating the effects of integration on trade.

¹¹ In this study, the human capital index has been quantified as the enrolment rate in secondary education, plus five times the enrolment rate in the tertiary level. These human capital indexes were calculated on the basis of data from the World Bank (1993). The data on GDP, intra-regional trade and the distances between countries were taken from SIECA (various issues).

On the basis of equation (1), the values of Panama's exports to four Central American countries were calculated (table 3). From these values, it was estimated that if Panama's exports were made under the provisions of the CACM, they would amount to US\$149 million: i.e., approximately three times the actual value registered in 1992. This is explained by the relatively high levels of human capital of Panama and Costa Rica, its main trading partner and closest neighbour.

Another approach used to measure the possible impact of Panama's entry into the CACM was the estimation of cross-section equations for the exports of the CACM countries and for Panama's exports to the

CACM, introducing dummy variables to measure the particular values of intercept ($D1$) and the distance coefficient ($D2$) when applying the model to the latter country's exports. The qualitative variables were significant in all the equations (table 4). Thus, equations (3) and (5) show that, as regards Panama's exports, their constant terms are lower by -1.66 and -1.38, respectively. These negative terms could be interpreted as a penalty on Panama's exports for not being a member of the CACM. Equations (4) and (6), for their part, indicate that Panama's exports suffer "frictions" of -0.23 and -0.19, respectively, because of the greater distance than that of the CACM countries.

TABLE 3

Panama: Estimates of the country's exports if it were a member of the CACM
(Millions of dollars)

Exports to:	Estimated amount using equation (1)	Estimated amount using equation (4)	Estimated amount using equation (6)	Actual amount (1992)
Costa Rica	96.54	139.00	105.6	29.1
Nicaragua	28.22	7.35	5.5	1.4
Honduras	1.08	5.52	13.4	3.2
El Salvador	23.10	70.30	51.9	12.3
Guatemala	-	-	16.8	3.9
<i>Total</i>	<i>148.94</i>	<i>222.17</i>	<i>193.2</i>	<i>49.9</i>

Source: Prepared by the author.

TABLE 4

Gravity model, including Panama, with qualitative variables for intercept ($D1$) and distance ($D2$)

Dependent variables	Independent variables ^a									
	C	H_i	H_j	Y_i	Y_j	\hat{D}_{ij}	$D1$	$D2$	R^2	DW
(3) Log E_{ij}	-11.33 (1.88)	3.16 (3.36)	1.47 (1.92)			-1.11 (1.67)	-1.66 (2.17)		0.61	2.32
(4) Log E_{ij}	-11.03 (1.83)	3.09 (3.29)	1.40 (1.81)			-1.07 (1.56)		-0.23 (2.11)	0.60	2.29
(5) Log E_{ij}	-7.92 (1.93)			1.33 (4.44)	0.46 (1.69)	-0.59 (1.45)	-1.38 (2.33)		0.62	2.15
(6) Log E_{ij}	-8.13 (1.98)			1.33 (4.46)	0.46 (1.71)	-0.57 (1.36)		-0.19 (2.40)	0.62	2.16

Source: Prepared by the author.

^a Logarithms of the independent variables.

On the basis of these results, an estimate was made of the difference that integration could make for Panama's exports. For this purpose, it was assumed first of all that Panama's entry into the CACM would eliminate the negative additional terms of the constants in equations (3) and (5). Thus, on the basis of equation (3) it was calculated that if Panama entered the CACM its exports would increase by a factor of 5.26, while on the basis of equation (5) it was estimated that exports would increase by a factor of 3.97 (exp. (1.38) = 3.97).¹² An estimate was also made of the extent to which Panama's exports would increase through entry into the CACM, on the basis of equations (4) and (6). In this case, likewise, it was

assumed that the terms penalizing Panama's exports (-0.23 Log D_{ij} and -0.19 Log D_{ij}) would not exist if Panama were a member of the CACM. In the case of equation (4), it was estimated that Panama's exports would increase by a factor of 4.8, while in the case of equation (6) it was estimated that they would increase by a factor of 3.8.

In order to estimate Panama's imports from the CACM, assuming that the country entered that integration scheme, a method similar to that employed for exports was used. Thus, equations were estimated for Panama's imports from the CACM, using the qualitative variables $D1$ and $D2$ for Panama as an importing country (table 5).¹³

TABLE 5

Gravity model for imports, specifying Panama with qualitative variables for intercept ($D1$) and distance ($D2$)

Dependent variables	Independent variables ^a							
	C	H_i	H_j	D_{ij}	$D1$	$D2$	R^2	DW
(7) Log (M_{ij})	-7.9227 (1.60)	1.4551 (1.88)	2.3896 (3.78)	-1.0581 (1.94)	1.0713 (1.71)		0.70	2.36
(8) Log (M_{ij})	-7.7607 (1.57)	1.4171 (1.84)	2.3458 (3.70)	-1.0204 (1.83)		-0.1483 (2.81)	0.69	2.35

Source: Prepared by the author.

^a Logarithms of the independent variables.

Equation (7) was used to calculate the probable increase in Panama's imports if that country joined the CACM. It was estimated that the increase would be US\$198 million, which is less than the increase of US\$241.96 million in the country's exports calculated on the basis of equation (3). This indicates that if it entered the CACM, Panama would be able to close its trade deficit with that market, which came to US\$36 million in 1992.

Similarly, using equation (8), Panama's imports from four CACM countries were calculated (table 6). It may be noted that if Panama entered this integration scheme, these imports would amount to US\$191.72 million, in contrast with a total of US\$222.17 million for its corresponding exports.

¹² The main explanatory variables in equations (3) and (5) are the amount of human capital and the size of GDP, respectively, and in both these cases Panama registers relatively high values, thus explaining the substantial increase that Panama's exports would register if it were a member of the CACM.

Thus, the estimated models indicate that Panama would improve its trade balance with the CACM if it joined the group.

TABLE 6

Panama: Estimate of the country's imports if it were a member of the CACM (Millions of dollars)

Imports from:	Estimated amount (equation (8))	Equation of actual amount
Costa Rica	155.36	56.7
Nicaragua	2.91	1.0
Honduras	9.12	3.0
El Salvador	24.32	7.9
Total	191.72	68.6

Source: Prepared by the author.

¹³ The results are not presented using the GDP as an explanatory variable because the coefficients of determination and the statistical significance of the estimators proved to be very low.

VIII

Final considerations

The Panamanian economy has registered export booms which could give rise to a relative contraction in the manufacturing and industrial sectors. This would also contribute to a contraction in investment and exports of goods. Within this context, a very marked demand for protection has arisen. This reaction, which is not in keeping with the regional and international trends towards modernization and competition, confirms the need to change the structure of the country's economy.

Economic integration could be a valuable means for aiding in the tasks of modernizing production. Firstly, the economic liberalization process would enjoy greater credibility, because there would be a multilateral commitment to adjustment; secondly, the cost of the adjustment could be reduced by increasing exports, and thirdly, it could serve to promote increased productivity, which would be an effective means of offsetting the ill-effects of the "Dutch Disease".

Of the various integration options that Panama might consider, the Central American integration programme could be the most promising, since there

would be greater creation of trade and intra-industry trade would develop more among countries with similar levels of GDP and per capita GDP. Panama's integration with the CACM should be viewed as a measure which would bring that country closer to its national goals, especially through the acquisition of export experience and the strengthening of its competitiveness, as a first step towards integration with other schemes (such as NAFTA).

Panama's participation in a subregional structural reform scheme would allow it to take advantage of other countries' experience and gain access to international technical cooperation. This regional framework of change should cover both economic and social reforms, in order to consolidate the national integration needed to sustain regional integration.

Econometric estimates show that Panama could have a favourable export performance if it entered the CACM, because it has human capital of higher level than the present CACM countries (except Costa Rica), and human capital is the main determining factor of export capacity.

(Original: Spanish)

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The dual currency *bifurcation of Cuba's* economy in the 1990s: *causes, consequences* and cures

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In the 1990s, there has been a growing split in Cuba's economy between the traditional socialist peso-based component and the internationalized dollar-oriented and marketized component. This schism has been caused by a conjuncture of circumstances, including the expansion of tourism and foreign and mixed enterprise; the contraction and loss of confidence in the socialist economy; the weakening of the monetary role of the peso (owing to the rapid inflation arising from the financing of the fiscal deficit through money creation), and a grossly overvalued exchange rate. This dual currency and structural bifurcation of the economy shaped the pattern of income distribution, thereby influencing the economic behaviour of the Cuban people. Cubans with access to U.S. dollars in the internationalized part of the economy have higher incomes than those without such access, owing to the difference between the unofficial exchange rate and the official (commercial) rate. Because of this situation, Cubans performing valuable social functions in the socialist economy are rewarded meagerly by society while those in the internationalized economy are relatively well rewarded. In consequence, Cubans "chase dollars" by any means possible —legal, semi-legal, or illegal. The bifurcation has thus stimulated the return of a variety of social ills which had virtually disappeared by the early 1960s. Some recent policies, notably the fiscal policies of 1994 (which lowered the deficit, decelerated monetary emission and reduced peso inflation, thereby increasing the demand for pesos), and some institutional changes have helped to reduce the unofficial exchange rate and to reduce the bifurcation. However, it will be necessary to continue and intensify this process of change in order to reintegrate the economy. Specially important elements in this respect will be exchange rate policy, further liberalization of small and medium-sized enterprise, and decontrol of prices (which will also call for the redesigning of the social "safety net").

I

Introduction

In the first half of the 1990s, in particular, Cuba's economy became increasingly split between the traditional socialist economy based on the old peso, on the one hand, and the rapidly expanding internationalized dollar-based economy together with the domestic market-oriented peso economy, on the other hand. These two parts of the economy interacted in a number of ways to generate a severely dysfunctional structure of incentives shaping people's economic energies in counterproductive ways and generating pervasive economic irrationalities. The reintegration of the economy is therefore necessary if human, natural and capital resources are to be used productively: presumably a major imperative in the current situation of severe depression. Reunification of these parts of the economy into a market-oriented system is vital if economic recovery, adjustment and transition are to occur.

Reintegrating these two parts of the economy will require a battery of policy changes which will be economically, politically and socially difficult in the short term. The policy areas must include the exchange rate, the monetary system, price decontrol, enterprise liberalization, harnessing of the mixed public and private "Sociedad Anónima" conglomerates, and redesigning of the social safety net. Indeed the task of unifying the two parts of the economy is a central feature of the general processes of both adjustment and transition.

The objective of this essay is to explore the characteristics, functioning, origins and consequences of the bifurcation of the Cuban economy in the 1990s and to examine the policy changes required to reintegrate the economy. In section II of this paper, the dualistic structure of the economy is described and the mechanics of its functioning are analysed. Next, in section III, the general economic consequences of this bifurcation are examined. The official approach to dealing with the bifurcation as of the first half of the 1990s is discussed in section IV, and finally, the policies required to "heal the split" or to reintegrate the two parts of the economy are analysed in section V.

It must be noted that a structural analysis of the Cuban economy in the 1990s is difficult to undertake due to the lack of concrete information. Since 1989, the Cuban government has not published comprehensive statistical data on the economy of the sort published between 1970 and 1989.¹ But the extent of the bifurcation of the economy was not really observed prior to about 1993. Some of the important policy changes which have been connected with the bifurcation—the legalization of the use of the U.S. dollar, the legalization of self-employment, and the establishment of agricultural markets, for example—were only introduced since mid-1993, so that there has been little time to reorganize information gathering and publication by the private and public sectors.

□ A number of people have provided valuable comments and critiques on this essay or have participated with me in informal discussions of Cuba's current economic situation. Among these are Carl McMillan and Keith Acheson of Carleton University in Ottawa, Canada, and Nobina and Keith Robinson, who are currently in Havana, Cuba; Francisco León, Joseph Ramos, Jorge Katz, Juan Carlos Lerda and Michael Mortimore, of ECLAC, Santiago, Chile; and various analysts and observers of the Cuban situation. The responsibility for the interpretations, analyses and any errors in the essay, however, lies of course with the author.

¹ Even Cuban economic analysts in the universities and numerous research institutes are reduced to relying on the newspaper *Granma* for the basic statistical materials for much of their work on the Cuban economy. Such official secrecy concerning information on the economy cannot fail to lower the quality of economic analysis at a time when good analysis is of the utmost importance for the rethinking and redesign of economic policy. Forcing Cuban analysts to work without good basic information obstructs their endeavours to contribute to an understanding of the economy and wastes their talents and energies.

II

The dual currency character of the Cuban economy

In the early 1990s the predominant characteristic of Cuba's economic structure was its bifurcation between the traditional socialist peso-based economy and the internationalized dollar-based part of the economy. The former was in a state of deep depression, organizational collapse, loss of confidence and general retreat. In contrast, the internationalized dollar-based part of the economy was expanding rapidly despite the recession, due to the increasing role of tourism and foreign investment, some public policy changes, and the vacuum left by the contraction of the traditional peso-based economy. The expansion of the internationalized part of the economy was reflected in two elements: first, an increase in dollar-oriented types of activities, including tourism, the presence of foreign businesses in joint ventures, various auxiliary goods and services, and dollar remittances from abroad, and second, the development of intermediate or transitional forms of market and quasi-market-oriented economic activity, including self-employment (both official and in the underground economy) and the economic activities operating through markets.

1. Characteristics and functioning

In mid-1995, the traditional socialist peso-based economy encompassed almost the whole of industry, with the exception of self-employed artisanal and industrial workers and some export-oriented joint ventures. Services also mostly came under this sector, including all of finance, most business services, some personal services (except those provided through self-employment), most wholesaling and retailing (except for the agricultural, industrial and artisanal markets), most transportation, and all communications. The role of the traditional socialist economy in agriculture was modified considerably as a result of the formation of the "Unidades Básicas de Producción Cooperativa" (UBPCs) in mid-1993. With the establishment of these cooperatives, the State sector's share of total agricultural land fell from 75% to 34%, while its share of cultivated land fell from 80% to 25% (see table 1). The role of the State as the provider of inputs and auxiliary services and purchaser of output quotas at controlled prices is still significant, however. It is not yet completely clear how authentically cooperative and

TABLE 1

Cuba: Land tenure, March 1994

	Hectares	Sectoral shares (%)			
		State	Cooperative	Private	UBPC ^a
<i>Total Area</i>	11 048 000	55.5	7.5	9.8	27.2
Agricultural land	6 741 000	34.0	11.0	14.0	41.0
Cultivated land	4 723 000	25.0	9.0	11.0	55.0
Under irrigation	964 000	25.0	8.0	6.0	61.0
<i>Selected crops</i>					
Sugar cane	1 918 000	9.0	12.0	2.0	77.0
Rice	191 000	41.0	9.0	12.0	38.0
Vegetables	524 000	16.0	15.0	48.0	21.0
Tobacco	57 000	11.0	12.0	49.0	28.0

Source: CONAS, 1994, p. 75

^a Basic cooperative production units.

autonomous the UBPCs will turn out to be. Nevertheless, the potential significance of this change in land tenure in Cuba is very considerable.

Within the traditional socialist sector, resource allocation was undertaken prior to 1990 through a centralized planning system, with the volume, mix and destination of enterprise outputs, the mix and origin of enterprise inputs, the pattern of investment within and among sectors and industries, and the nature of the external interlinkages of the enterprises all being ostensibly determined by the "Plan". The impossibility of planning all these aspects adequately resulted in much improvisation and heavy reliance on "sociolismo", that is, the solution of economic problems by the exchange of favours through circles of friends. The centralized system deteriorated with the problems of the 1990s and was replaced by ever-greater improvisation and "sociolismo". In this part of the economy, consumer goods are allocated through the rationing system for some basic foodstuffs and household necessities (with decreasing quantities from 1990 to 1994, it might be added) or on the basis of political considerations (in the case of cars, housing, consumer durables and foreign travel, which are allocated to politically deserving designated individuals).

The prices of virtually all consumer goods provided through the rationing system were frozen at, or close to, their 1960-1962 levels. Labour was allocated to sectors, industries and specific activities not through decentralized market processes but through centrally-taken decisions (with some individual choice of careers and economic areas, and with the State guaranteeing first-time job seekers employment in the areas of their educational training). In this sector, labour force remuneration is confined to a relatively narrow wage and salary scale (from about 80 to 480 pesos per month), supplemented by politically allocated items, at very low prices, and more recently by some hard currency (and after December 1994, convertible peso) payments to workers in certain important sectors (electrical generation, oil production, some fishing, port activities).

The internationalized dollar-based part of the Cuban economy consists of tourism and auxiliary services, foreign businesses operating with Cuban partners in joint ventures, and some of the large mixed enterprises and "Sociedades Anónimas" (these are State-owned but financially and manage-

rially autonomous conglomerate enterprises operating in the internationalized dollar-oriented economy and behaving much like private enterprises). By the mid-1990s, some State enterprises were undertaking work for the tourist sector for compensation in hard currency, and some special farm operations were being established to produce fresh vegetables for the tourist sector, with payment also in dollars. The "remittance economy" (those receiving dollars from abroad and spending them in the domestic market economy or "dollar stores") would also be included here. The domestic market economy—registered and unregistered self-employed persons, the agricultural, artisanal and small-scale industrial markets, and to a much lesser extent the UBPCs—likewise forms part of this sector of the economy. Although the private agricultural sector only accounts for 14% of total agricultural land, its share of agricultural value added is probably greater because of its disproportionate share of high-value crops such as vegetables and tobacco (see table 1).

The important role of the UBPCs in agriculture has already been noted, but their evolution is still unclear, and they might be considered to be in an early transitional state. Some personal services are provided through the market mechanism, at prices determined by market forces. Self-employed individuals produce a large proportion of artisanal products, but only a small amount of employment and value added would be generated by this sector in manufacturing and industry. There appear to be no estimates yet available for the new and rapidly changing structure of employment or value added according to public or private sector, marketized or non-marketized activities.

In this part of the economy, resource allocation occurs largely or partly through market mechanisms. For the self-employed, and for exchanges in the agricultural, artisanal and small-scale industrial markets, prices are determined by the forces of supply and demand within what often must be highly competitive markets with considerable ease of entry. In the artisanal markets, prices are expressed in pesos or dollars at the unofficial exchange rate and transactions may be in dollars or pesos. The agricultural and industrial market transactions are by law supposed to be only in pesos, but money-changers readily convert dollars to pesos at the prevailing unofficial exchange rate. Transactions with the self-employed can take place

in dollars or pesos, likewise at the unofficial exchange rate. The whole tourist sector, as well as the foreign business sector, operates in U.S. dollars. The "dollar stores", which now include a number of chains of stores importing foodstuffs, clothing, footwear, appliances, consumer electronics and other durables, and even candy, soft drinks and alcoholic beverages, as well as restaurants for foreigners and Cubans alike, are designed to "mop up" some of the dollars (and "convertible pesos") in circulation, with a substantial tax-equivalent profit received by the State.

Remuneration and earnings in this part of the economy are determined largely by market forces. For those who are legally or illegally self-employed, incomes are determined by the relative demand for the goods or services offered, *vis-à-vis* the nature of the competition and the production costs. This applies to all of the 166 categories of registered own-account workers legalized as from 12 June 1995, to those who were self-employed in the legalized categories but not registered, and to those providing goods or services which were still illegal at this time (e.g., some professional services.) For those in the tourist sector or providing auxiliary services, tips in foreign currency constitute the main remuneration. In the foreign business sector, foreign factors of production must be paid for in foreign currency, otherwise there would be no incentive to operate in Cuba. Cuban employees of foreign business are supposed to be paid in pesos; supplementary payments in dollars are illegal, but hard to prevent totally when enterprises find that maintaining labour force commitment requires such supplementation. The receipt of dollar remittances is, of course, not a remuneration for services rendered but a gift from relatives abroad.

2. The forces generating the dual currency bifurcation

The bifurcation of the Cuban economy into the peso-based and dollar-based components is mainly the result of economic policies and the institutional structure of the economy, together with the economic liberalization process.

These factors have interacted to generate the bifurcation as follows. First, with controlled, low prices in the State sector for rationed goods and services, the payments to human factors of production have

traditionally exceeded the value of goods and services available for purchase. The excess of remunerative payments over the value of rationed goods and services available increased sharply from 1989 to 1994 as the volume of output shrank. This was possible because price controls prevented any increase in prices, while the government was willing to cover the worsening operating deficits of State enterprises with grants which were financed by the printing of money or the creation of unredeemed and unredeemable credits. The creation of money, namely old pesos, for this purpose then generated the inflationary dynamics described above.

Second, this excess volume of money earnings then fed into the black market, putting upward pressure on the prices of goods and services in that part of the economy. Rising prices continued even after self-employment legalized some of the activities outside the controlled "socialist" economy. Such rising prices constituted by definition inflation, even though the official position until recently was that there was no inflation because of the price controls on the rationed goods and services. Third, as inflation continued and accelerated, reflecting the growing monthly excess of money earnings over the value of goods and services available in the socialist economy, it increasingly devalued the peso with respect to the value of the U.S. dollar. With worsening real inflation, what was happening was that Cubans were losing faith in the peso as a currency and turning to the U.S. dollar as a "money" for the performance of monetary functions.

Ultimately, by mid-1994, the value of the U.S. dollar reached levels as high as 100 to 120 pesos in the unofficial market, this peso devaluation being probably due to: i) the high demand for dollars by the "balseros" who were trying to convert their assets to dollars for transfer out of the country, or for the purchase of rafts; ii) extreme shortages of items which could be legally purchased for pesos at the time, and iii) a growing air of pessimism, loss of confidence and desperation on the part of many Cubans with respect to the prospects for the economy. The unofficial exchange rate subsequently declined somewhat, especially after the opening of the agricultural markets on 1 October 1994, which increased the demand for pesos and led to declines

in the prices of foods in terms of their earlier black market levels. The rate fell as low as 30-35 pesos to the U.S. dollar by April 1995, but appeared to be rising again by June 1995. Even at such a rate, the difference from the official rates -1 peso = US\$1 for tourism and 0.74 pesos = US\$1 for commerce- is most extreme in comparative historical terms.

Exchange rate policy and protectionism have also played an important role in the generation of this bifurcation. The socialist peso-based economy has an exchange rate of 0.74 pesos = US\$1, which makes imports of all sorts exceedingly cheap in terms of pesos and results in an impossibly huge demand for imports (far beyond what could conceivably be purchased with Cuba's foreign exchange earnings), which has to be limited by bureaucratic controls or non-tariff barriers (NTBs) to provide infinite protection against some imports or to allow other imports (medicines and foodstuffs, for example) to be brought in at the official exchange rate so that their cost to Cuban consumers is maintained at a low peso purchase price. This type of bureaucratic NTB has provided most of the socialist peso-based sector with impenetrable and infinite protection against competitive imports of final products. At the same time, some imported inputs, replacement parts and machinery and equipment have been permitted to enter the country at a zero tariff, thus constituting a major subsidy for the enterprises enjoying the right to import at the official rate. On the other hand, if the foreign exchange earnings from the exports of the traditional socialist economy are converted to pesos at the official rate, such enterprises earn very little and there is a major disincentive to expand and diversify exports.

The big dollar-oriented Sociedad Anónima conglomerates also use the official exchange rates. However, because many of these operate largely or partly in the internationalized part of Cuba's economy (in tourism, dollar-store retailing, export-import trade, or servicing foreign business, the diplomatic corps, or international organizations) they are empowered to import commodities at zero tariff. These com-

modities are then sold to tourists, Cubans with dollars, foreign business people, etc., duty free, but often with a substantial price mark-up which constitutes in effect a tax. So far the import bias of these conglomerates has been countered by various rules and directives designed to redirect their purchasing towards domestic sources.

Microenterprises have no right to import inputs at one of the official exchange rates, as they are not in priority areas of the economy, nor have they yet organized themselves into lobby groups which could petition the government for access to some imports at the official rates. Indeed, the microenterprise sector does not even have the right to obtain imports directly from abroad at the black market exchange rate, although inputs which have already been imported do reach this sector indirectly.

Thus, Cuba is in the paradoxical situation of having a highly variable and discriminatory system of effective protection and subsidization of imports through bureaucratic NTBs and extreme exchange rate overvaluation under which: i) the traditional socialist economy is subject to a wide range of NTBs, plus the overvaluation of the currency; ii) the transitional market economy faces virtually endless NTBs; and iii) many of the foreign-exchange-earning Sociedades Anónimas enjoy free importation of many goods at the very favourable official exchange rate.

Finally, the expansion of tourism and the growing presence of foreign business in the 1990s have contributed to the expansion of the internationalized dollar-oriented economy. From 1990 to 1993, the number of tourists increased from about 340 000 to 550 000, while gross income from tourism increased from US\$189 million to US\$720 million, although the value added within Cuba constituted only about 30% of gross income in 1994, according to officials of the Ministry of Tourism (16 February 1995). Likewise, a growing number of foreign businesses have established branches or entered into joint ventures with Cuban State enterprises. Tourists, foreign businessmen and foreign businesses must all operate with dollars.

III

Consequences of the bifurcation of the economy

1. Income distribution and the general structure of incentives

The most important and best-known consequence of the bifurcation concerns income distribution and the general structure of incentives. Essentially, in the traditional socialist economy the wage and salary structure ranges from about 80 to 480 pesos per month. At the unofficial exchange rate (40 pesos per U.S. dollar in early 1995), this is equivalent to US\$2.00 to US\$12.00 per month. At the commercial exchange rate of 0.74 pesos per U.S. dollar, the level of incomes is obviously much higher, but this exchange rate is virtually meaningless for private citizens.

On the other hand, those who are able to earn or receive foreign currency, especially U.S. dollars (through work in the tourist sector or auxiliary services, the foreign business sector, services provided outside of Cuba for convertible currency, or remittances from relatives abroad) can enjoy substantially higher real incomes. For example, a bartender or elevator operator in the tourist sector may receive an average of, say, US\$30.00 per month in tips, which would be equivalent to some 1 200 old pesos per month: up to 1000% of the peso income of a person with similar qualifications working elsewhere in the economy, and up to 250% of the top of the peso wage and salary scale. Similarly, an engineer who drives his car as an unregistered taxi might earn US\$50 to US\$150 per month (or even much more), which would be around 2 000 to 6 000 old pesos or 8 to 20 times the peso income which could be earned in the traditional socialist economy. These examples could be multiplied *ad infinitum*.

Those who are self-employed or who sell their goods or services on the market also usually receive higher incomes, because the prices at which their sales are made are market-determined in the context of the excess money incomes which most Cubans have after they have spent their old peso incomes on the rationed commodities. However, these prices and hence the incomes of the self-employed are constrained by the relative "freedom of entry" into

registered (or unregistered) market activities, with the large numbers of competing self-employed tending to keep prices and incomes down. Low barriers to entry, plus the increase in the number of potential entrants to this micro-enterprise sector (due to the present and probable future downsizing of State enterprises, public services and some of the professions) should push prices and incomes to even lower levels in future.

Generally speaking, the internationalized dollar-oriented economy generates income levels which are usually high in comparison with the incomes generated in the traditional socialist economy. Though the gap in real incomes may be less than the apparent gap in nominal old peso terms, the gap can be and often is very large. People's incomes in old pesos permit the purchase of rationed foodstuffs, but the rations available per month usually lasted for only 7 to 14 days by 1994, leaving serious family food shortages. Incomes in old pesos typically would also permit the purchase of other rationed goods such as household and personal hygiene products and some items of clothing per year. But for the purchase of foodstuffs from the agricultural markets (or, prior to 1 October 1994, from the black market) and from the industrial and artisanal markets, large amounts of pesos are required as these prices are market-determined. For purchases of foodstuffs, personal hygiene products, clothing, footwear, or consumer durables from the "dollar stores", dollars or "convertible pesos" are naturally required.

The implications of this pattern of income distribution for the general structure of incentives which shape people's activities in their material lives are obvious. Because the real value of incomes in old pesos in the traditional socialist economy is low in comparison with the value of real incomes in the internationalized dollar-oriented economy and the market-oriented economy, people in effect choose the latter. In other words, Cubans tend to chase dollars. In practical terms, this means that professors with a knowledge of English or some other tourism-oriented language move to the tourist sector; young men and women who should be focusing on their school work

in preparation for a job in the public sector or professions switch to being "jineteros" or "jineteras"; nurses leave their employment to earn dollars, etc. Even people with quite good jobs in the traditional socialist economy are under great pressure to earn or acquire dollars or large amounts of old pesos through self-employment or part-time provision of services ("moonlighting").

From the standpoint of society, it is regrettable that those who carry out functions in the traditional socialist economy which are often of great importance to the community (in education, health, and agricultural and industrial work, for example) are poorly rewarded, while other activities which may be less important for society (e.g., selling cigars on the street) are highly rewarded. Indeed, the irony of the situation is that those who have been among the strongest supporters and beneficiaries of the Revolutionary regime in the traditional socialist economy (soldiers, workers, educational and health professionals) have been suffering material deprivation, whereas Cubans who have maintained good relationships with family members abroad, small-scale entrepreneurs and hustlers of various sorts receive substantially higher incomes, either in dollars or through better-rewarded self-employment.

2. Implications for resource allocation: market forces, "micro-irrationalities" and dysfunctionality

The high incomes and resulting incentives for people who shift their energies to the internationalized dollar-oriented economy and away from the traditional socialist economy are ultimately a market-driven phenomenon. In some ways, they are a normal or natural response to the increased importance of foreign exchange and imports following the loss of some 70-75% of Cuba's capacity to import. Shifting resources towards the foreign-exchange-earning sector (tourism in this case) is a necessary part of the process of Cuba's structural adjustment, so that foreign exchange earnings can increase and import levels can rise above their very low current level. The shift of resources to the internationalized sector is "market-driven" in the sense that real economic scarcity of imports of all sorts is a major force pushing the black market exchange rate to high levels.

Unfortunately, some of the key foreign exchange earning sectors, such as sugar, citrus fruit and coffee,

are in the traditional socialist economy and not the internationalized part, so that their revenues are in pesos at the official commercial rate of US\$1.00 = 0.74 pesos. Consequently, unlike tourism, these sectors do not receive the benefit of the hard currency they earn for the country. Instead, their low remuneration in real terms results in shortages of inputs of all kinds, and especially imported inputs such as replacement parts, new capital equipment and intermediate inputs. Further consequences of this situation include the ongoing deterioration of the capital stock and especially loss of human resources, as employees leave their employment in the traditional peso economy in an attempt to earn dollars or larger amounts of pesos through self-employment. The severe discrimination against most foreign exchange earning sectors which results from the dual currency bifurcation must be one of the most destructive irrationalities in the functioning of the Cuban economy during the mid-1990s, when the need for foreign exchange is so urgent.

While there is an underlying economic logic to the reallocation of resources to the internationalized and domestic market economy, there are also pervasive micro-irrationalities in the functioning of the economy which add up to a giant economic dysfunctionality. Because of the controlled and very low prices in the traditional socialist economy, a variety of goods and services can be purchased at the controlled prices and resold at higher market-determined prices in pesos or dollars (at the black market exchange rate). Likewise, commodities in the socialist economy can leak out by theft or graft of various sorts and be resold at the high market-determined prices. There are numerous examples of this. For example, rationed rum can be purchased at the controlled old peso price and resold at a much higher price. Virtually any foodstuff acquired at the official price can be resold at a high profit. Gasoline acquired at the rationed peso price can also be resold for dollars, and any item imported at the official commercial exchange rate can be resold at a much higher black market or dollar price.

The result of the myriad of profit-making opportunities arising from price controls and imports at the official exchange rate is a massive volume of "rent seeking". It is highly remunerative for people to devote their creative economic energies to buying and selling between the two economies. Indeed, often the profits to be made on the purchase of an item for

pesos in the socialist economy and its resale in the internationalized or domestic market economy are so large that it is more remunerative for people to leave their formal employment altogether (or preferably to resort to continued absenteeism) and to devote themselves to "rent-seeking". The consequence of this ubiquitous practice is that the productive work of the population is de-emphasized and ignored, while disproportionate amounts of energy are devoted to buying and selling, although some of the transactions would be needless or of limited usefulness under more normal circumstances.

The second type of irrationality concerns the high cost in real terms which Cuba as a society pays to reallocate human resources to the internationalized economy. While this reallocation is necessary in the current circumstances and always involves some kind of costs, one cannot help but feel that the costs involved are excessive under the dual currency economy of the mid-1990s. For example, is it really appropriate to remunerate doctors, nurses and factory workers in old pesos and at the old wage and salary scales while unskilled workers in tourism receive much higher real incomes through their tips? While one hesitates to make value judgements of this sort, it does appear that Cuban society devotes a large volume of real resources to incentivate and remunerate such individuals in the dollar-oriented economy, while those in the fixed price peso-oriented economy are rewarded meagerly.

3. Social consequences of the bifurcation

Interacting symbiotically with the decline in Cuba's real per capita income since 1989, the dual currency bifurcation of the economy has generated a number of negative social consequences. These include the impacts on income distribution, work habits and "rent-seeking," difficulties in maintaining "one-tier" systems for the provision of basic social services, and the re-emergence of social ills which had been virtually eliminated in the early years of the revolutionary regime.

As already noted, income distribution has been affected significantly by the dual currency bifurcation. Those people who worked in the socialist economy and had no access to U.S. dollars were in effect penalized and were receiving very low real incomes by 1993-1995, whereas those who were able to earn or receive U.S. dollars or who were earning market-

determined peso incomes were generally faring quite well. It may be added that those with privileged access to some imported items (e.g. cars and gasoline) at the official exchange rate and those with access to some privileged consumption through their connections with important institutions were also doing relatively well, as was also the case before 1990. This pattern of income distribution is a social problem in that groups of people who perform valuable services for society but work in the traditional peso economy are penalized with low real incomes, whereas "rent-seekers" who devote their energies to intermediating between the two economies may receive very high incomes by providing services which would be unnecessary and unprofitable if Cuba's economic structure were unified rather than bifurcated.

A further consequence of the bifurcation operating with the decline in real incomes is the reemergence of begging, hustling, prostitution or quasi-prostitution and crime. All of these ills had largely disappeared or been greatly reduced by the mid-1960s, but all re-emerged on a large scale and very conspicuously by the mid-1990s. By 1994, foreigners—who seemed to be easily identifiable by Cubans—would be approached and asked for dollars. In Havana, this was done most often by children, but also by pensioners and mothers with children. This begging did not seem to be full-time professional begging of the sort one encounters in some Asian countries, but appeared rather to be a part-time activity undertaken by adults when they were desperate, in the context of a situation where US\$1.00 acquired by begging was equivalent to 35-50 old pesos, which was for many a week's wage or more. Begging by children may sometimes be due to the extreme poverty of the family, but it also sometimes seems to be of a much less urgent character, as children often use their dollar receipts from begging to buy imported candy, soft drinks, etc. (conveniently sold in vending machines and kiosks owned by the *Sociedades Anónimas*).

"Hustling"—quasi-legal or downright illegal "rent-seeking"—has emerged on a major scale. Young men, the so-called "jineteros," seek to acquire dollars by reselling boxes of cigars, bottles of rum or some "medicines", or by procuring women or providing companionship for persons in the internationalized part of the economy. Young women or "jineteras" provide companionship or sexual services for men in the internationalized economy, often earning very

high incomes. Many of them appear to operate on a part-time income-supplementing and amateur basis rather than as full-time professionals, but little firm evidence is available on this activity despite its conspicuousness and scale.²

Crime is said to have increased significantly. Comments among the people, and the security systems used in the internationalized economy, together with the security precautions that most people now take in Havana suggest that the large income gap between the traditional socialist peso-based economy and the internationalized dollar-based economy has increased the incentive for theft. Unfortunately, there are no statistics with which one might corroborate or disprove this.

Finally, the dual currency bifurcation of the economy, plus the economic contraction, are making it difficult to maintain a good-quality one-tier educational and health system. The public health system has deteriorated seriously due to lack of imported inputs, low budget allocations, and very high absenteeism on the part of hospital staff. Medicines are also often very scarce in the peso economy. As a

result, people with access to U.S. dollars often use them to purchase medicines in the dollar stores or to supplement the meals, supplies and medical items available in the hospitals. It does not seem likely that many doctors are providing medical services outside the State system for dollars or market-determined fees, since this is highly illegal and doctors have been explicitly prohibited from entering private practice (self-employment). However, in line with traditions long predating the Revolution, it seems that in some areas patients make supplementary payments in kind for medical services. At all events, it appears to be becoming more difficult to prevent the gradual shift to a two-tier medical system, which would be a major departure from the regime's commitment to provide similar medical care for all. In education, there seems to have been a deterioration in quality, according to what people say, as teachers reduce the time and attention devoted to teaching in order to acquire dollars or supplement their incomes in old pesos. Consequently, some parents are increasingly paying for extra-curricular instruction for their children or teaching them themselves.

IV

Reunifying the economy (1993-1995)

The government only seems to have become fully aware of the increasing dual currency bifurcation of the Cuban economy after the decriminalization of the use of the U.S. dollar in the summer of 1993. This measure perhaps made the bifurcation of the economy and its consequences easier to grasp, but the real bifurcation existed as far back as the mid-1980s and became severe after about 1990. It is interesting to note that some of the main analyses of the Cuban

economy before about 1994 do not refer to or analyse this phenomenon (Carranza, 1993 and Lee, 1993, for example). The appointment of Dr. José Luis Rodríguez as Minister of Finance signalled a greater concern on the part of the government with the worsening fiscal deficit (financed by money creation) and its implications. The support which Dr. Rodríguez then enjoyed and the adoption by the National Assembly of a package of measures designed to reduce the fiscal deficit indicated that by 1994 the underlying causes and the negative consequences of the bifurcation were better understood.

A number of the reforms introduced after the summer of 1993 have had the indirect or direct result of decelerating or reversing the bifurcation.

1. Fiscal policies

The set of measures enacted in 1994 by the Ministry of Finance to reduce the fiscal deficit have helped to

² Mirta Rodríguez Calderón, a journalist and co-founder of MAGIN (Asociación de Mujeres Comunicadoras), maintains that "jineterismo," as practiced by young Cuban women, is not necessarily the same as the sale of sexual favours for cash and is thus quite distinct from pre-1959 prostitution in Cuba. Often dining, concerts, dancing, sight-seeing, visits to the dollar store, or companionship are involved, but "the meter is always ticking". Some young women cherish the hope of marrying a foreigner and leaving the country, and young men also provide such companionship for foreign women, sometimes achieving marriage and emigration in this way (Strout, 1995, p. 3).

reduce the tendency towards bifurcation. By reducing the deficit from about 5.1 billion pesos in 1993 (some 28% of estimated GDP) to an estimated 1.4 billion pesos in 1994 (about 7-8% of GDP), the volume of money created to finance the deficit was reduced significantly (*Granma International*, 1995, p. 4). The result of this has been a reduction in the excess of old pesos fed into the economy over and above the value

of price-controlled goods and services, thus also reducing the upward pressure on black market or market-determined prices as well as on the black market price of the U.S. dollar. If the fiscal deficit declines further in 1995 as a result of these tax increases and expenditure cuts, uncontrolled prices and the unofficial exchange rate for the U.S. dollar should rise at a still slower rate.

TABLE 2

Cuba: Main economic indicators, 1985-1995

	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995
Estimated GDP (\$US, billion)	32.3	32.6	31.4	32.2	32.5	31.5	23.6	20.3	18.3	18.4 ^e	...
Estimated per capita GDP (\$US)	3 181	3 182	3 032	3 076	3 076	2 971	2 226	1 897	1 679	1 640 ^e	...
Change in per capita GDP (%)	(3.5)	-	-4.7	1.5	-	-3.4	-25.1	-14.8	-11.5	-2.3 ^e	...
Per capita GDP, index (ECLAC)	100.0	99.7	95.4	96.5	96.4	92.5	68.7	58.6	52.4	51.8 ^e	...
Total exports (\$US billion)	5.99	5.32	5.40	5.52	5.4	4.9	3.6	2.2	1.7	1.8 ^e	...
Total imports (\$US billion)	8.04	7.60	6.58	6.58	8.1	6.7	3.7	2.5	2.2	2.3 ^e	...
Hard-currency external debt (\$US billion)	3.9	6.0	5.7	6.5	6.2	7.0	8.4	10.0	10.8
Budget deficit (Billions of pesos)	0.3	0.2	0.6	1.1	1.4	2.0	3.7	4.2	5.1	1.4 ^e	...
As a percentage of estimated GDP	0.9	0.6	1.9	3.4	4.3	6.3	15.7	20.7	27.9	7.6	...
Sugar harvest (Millions of metric tons)	7.9	7.5	7.2	8.1	7.6	8.4	7.2	7.0	4.3	4.0	3.5 ^e
Petroleum imports (Millions of metric tons)	13.5	13.2	13.5	13.4	13.3	11.6	9.2	6.2	5.7	6.2	...
Petroleum production (Millions of metric tons)	0.9	0.9	0.9	0.7	0.7	0.7	0.5	0.9	1.1	1.3	1.4 ^e
Total petroleum (Millions of metric tons)	14.4	14.1	14.4	14.1	14.0	12.3	9.7	7.1	6.8	7.5	...
Exchange rates											
Official tourist rate (Pesos/\$US)			1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Official commercial rate (Pesos/\$US)			0.74	0.74	0.74	0.74	0.74	0.74	0.74	0.74	0.74
Unofficial rate (Pesos/\$US) ^b					5	7(9)	20(12)	35(7)	55(6)	100(11)	35(10)

Source: CONAS, 1994; CEE (C6mite Estatal de Estadisticas), 1989; Terrero, 1994; Centro de Estudios sobre la Economfa Cubana, 1995; ECLAC, 1994.

^a Estimate.

^b Figures in brackets indicate months.

The fiscal measures designed to reduce expenditures and increase revenues included the following:

- a reduction in subsidies to enterprises from an actual level of 5.4 billion pesos in 1993 to a budgeted level of 2.2 billion pesos in 1995, through the authorization of higher prices and stringent measures to promote self-financing;
- price increases for some items, such as cigarettes, cigars and rum;
- increased charges for services such as electricity, telephones, transportation and postal services;
- introduction of charges and elimination of subsidies for workers' dining rooms, school lunches, vitamin supplements and foreign language courses;
- charging of entry fees for sports events, museums and art galleries;
- increases in the charges in U.S. dollars collected from foreigners for such services as telephones, electricity, postal services and the use of airport facilities;
- increases in prices in all dollar stores;
- taxation for self-employed workers (through registration fees at first);
- income taxes for citizens earning foreign currencies;
- probable increases in tariffs on some imported items such as donated vehicles (a tariff of 100% in old pesos on the basis of the U.S. dollar price);
- reductions in some components of public expenditure prior to 1995 (details not yet available).

By helping to reduce the fiscal deficit that subsequently has to be financed by the creation of money, all these measures help to ease the bifurcation.

2. Reform measures

Initially, there appears to have been a paralysis in public policy making which lasted from 1990 to mid-1993. Although the economy was contracting seriously in these years, no significant reform policies were introduced (the National Food Programme, presented in the National Assembly in December 1990, was essentially an old-style "campaign" involving more intensive planning for the reallocation of resources to agriculture. Its results were minimal, partly because the national economic contraction

prevented the large infusion of imports and resources which the Programme required). As the contraction continued, however, a do-nothing approach by the government became increasingly indefensible. Meanwhile, citizens were improvising their own survival strategies to cope with the difficult circumstances they were facing. These strategies usually involved economic initiatives outside the formal planning system and the traditional socialist economy, and these initiatives mostly involved "chasing dollars" in the internationalized part of the economy, various types of "rent-seeking" between the traditional socialist and internationalized parts of the economy or through black market transactions of various sorts, or the provision of goods and services in the underground market economy.

The reform measures introduced after mid-1993 mostly legitimized the economic activities which Cubans themselves had undertaken as they tried to improve their own survival strategies. The reforms were essentially official responses to the grass-roots behaviour and pressures of Cuban citizens in a situation in which there appeared to be no other public policy options that were reasonable, credible or viable. The reform measures have strengthened the internationalized part of the economy and have permitted the emergence of what might be considered a third component of the economic structure, though it is closely related to the internationalized part. This third component is the domestically-oriented peso/dollar market economy which has resurfaced since the introduction of the reform measures and has grown rapidly since the new laws were passed.

The first major reform measure to be introduced following the period of policy paralysis was the decriminalization of the holding and use of U.S. dollars by Cubans, in August 1993. This measure gave official recognition and legitimacy to what many Cubans were already doing. However, the measure also increased the use of the dollar in normal day-to-day transactions because of the elimination of the fear of prosecution, which had been a major concern and impediment to the use of the dollar prior to this. The legalization of the use of the dollar and the consequent increase in the demand for dollars for transactions and "nest egg" purposes probably contributed to the initial rapid appreciation of this currency from mid-1993 to mid-1994. At all events, this measure strengthened the dollar-oriented economy and the use of the dollar for domestic transactions.

The liberalization of self-employment in micro-enterprises in September 1993 permitted people in 147 types of economic activity to officially register and function legally and "above ground" (Gobierno de Cuba, 1994a). By late 1994, some 170 000 persons had registered as self-employed, with over 48 000 in Havana alone (*Granma*, 1995, p. 3). The expansion of this sector provided a growing outlet for the excess money incomes. As it expands, prices may be driven down further, although this also depends on the rate of money creation, which in turn depends largely on the fiscal deficit. Of particular significance for the expansion of the market mechanism was the re-establishment of agricultural markets on 1 October 1995. The legislation in this connection explicitly states that prices in these markets are to be determined by supply and demand; that all types of agricultural producers are eligible to use them (including private farms, State farms, UBPCS, army farms, backyard gardeners, and various other types of cooperatives); that the whole of Cuba is to be an integrated market with freedom to transport agricultural products to anywhere on the Island; but that farms can sell in these markets only after their contracts with the State have been fulfilled.

A related law of 7 October 1994 liberalized transportation by authorizing any owner of transport facilities such as trucks to contract directly with farms to move foodstuffs to market (Ministerio de Transporte, 1994). These two laws had a variety of beneficial effects quite quickly. In the last three months of 1994, an estimated 20% of total food suppliers were going through these markets, and some estimates were even higher (*Granma Internacional*, 1994). Thanks to these, food availability in urban areas increased and food prices sank well below the

black market levels. They provide incentives for all farms to expand their production in coming crop years, so that supplies should increase and prices fall still further. The subsequent legalization of industrial and artisanal markets (1 December 1994) was modelled closely on the measures governing agricultural markets. The growth and impact of these markets so far have been less dramatic than in the case of the agricultural markets, but generally speaking these markets appear to have a considerable variety of manufactured products such as kerosene stoves, aluminum kitchen utensils, shoes and clothing, all aimed at the domestic market. Craft workers and artists are producing a remarkable and rapidly expanding variety of items not only for the tourist market but also increasingly for the large numbers of Cubans who have access to dollars.

In short, the legalization of self-employment, the establishment of agricultural, transport, industrial and artisanal markets, and the conversion of State farms to cooperatives has increased the role of the price mechanism and the scope of the market economy. This part of the economy, though closely related to the internationalized dollar-oriented economy, is somewhat distinct in that it is more domestically-oriented (though not totally), and it is more peso-based (though again not totally). This marketized part of the Cuban economy represents, in part, a fusion of the internationalized dollar-oriented and the traditional socialist part of the economy. Indeed, the movement towards a mixed market economy must necessarily involve the steady expansion of this marketized component and the steady convergence of the socialist economy and the internationalized economy towards that component.

V

Reunification, transition and adjustment in the future

A variety of public policy initiatives and institutional changes will ultimately be required for the unification of the two parts of the economy. So far, some important reform measures have been introduced, as discussed in the previous section, but a number of other measures will also be necessary.

1. Enterprise liberalization

The legalization of self-employment in micro-enterprises and the establishment of markets in which they can legally operate was an important positive step, as already noted. However, the evolution of this

sector is still hindered by a number of legal provisions. The limitation on the size of enterprises—which are officially self-employment ventures but in practice are sometimes family enterprises—is particularly restrictive. Many types of economic activity need to be larger if they are to operate effectively and efficiently.

Second, the range of self-employment legalized from September 1993 to July 1995 excludes a broad variety of “high-technology” types of enterprise and restricts the permitted activities to those which are mainly of a “low-tech” character (*Granma*, 1993, p. 5). Business service enterprises in particular—technical consultants, management consultants, computer firms, accountants, law offices, marketing firms, surveying firms, office services, architects, geological exploration, etc.—can all provide important inputs to public and private sector firms in a cost-effective manner and they need to be legalized if Cuba is to develop a sophisticated modern economy. This also means that university graduates, with the continuing exception of medical personnel, should be permitted to enter these new types of self-employment. A variety of personal services and some small-scale manufacturing could be usefully legalized as well.

Third, the legislation for microenterprises prohibits private retailing, which dooms the sector to continued low-level operation, as each producer must also be the retailer. Stores which would bring together a range of products and varieties of products are thus effectively blocked.

Fourth, it would be beneficial if property legislation were modified to permit retailers and producers to re-establish stores and specialized shopping areas. Is it reasonable to confine sales of agricultural, artisanal or industrial products to specific market sites, some of which are already quite overcrowded? The liberalization of the rules on the location and rental arrangements for such enterprises would be very useful for improving the quality of many types of services to the public.

In short, the removal of a number of restrictions on the development of this sector could generate employment, improve the material quality of life for Cuban citizens, and improve the productivity of large-scale public or private enterprises through the provision of business services. All of these are priority concerns at present. Lifting the limitations on the development of this sector would also permit the acceleration of entrepreneurial learning in the area of small enterprise management: a learning process

which has been blocked since the 1960s but which will be of vital importance when Cuba normalizes its relationship with the United States (and experiences a major inflow of Cuban-American financial, technological, managerial and entrepreneurial expertise).

Finally, easing the restrictions on the development of micro-enterprises is also vital as a means of increasing the demand for pesos and the supply of goods and services available for the public, which would put downward pressure on market-determined price levels and on the black market exchange rate for the U.S. dollar.

2. Institutional changes

In the process of transition to an “economy with the market” a wide variety of institutional changes will be necessary, some of which will play an important part in the reunification of the traditional socialist peso-based and internationalized dollar-based parts of the economy. The most important changes of this sort, apart from enterprise liberalization, which has already been discussed, will perhaps be the establishment of markets for housing, cars and other physical assets, privatization and cooperativization, and the redesigning of the “Sociedades Anónimas”. Other institutional changes, such as reform of the financial and banking system, the establishment of a regulatory framework for the functioning of the private sector, and the redrafting of property legislation, for example, are important for an economic transition, but perhaps less central to the issue of the unification of the economy.

The legalization of markets for housing and other physical assets would be a useful step in itself, as well as its effect in increasing the demand for pesos and helping to reduce the black market exchange rate and other market-determined prices. At present, people must either sell their homes, at a price expressed in old pesos, to the State, which then allots housing on the basis of political criteria, or else people can exchange their homes in return for the unofficial transfer of a suitable amount of cash, so that a market of sorts could be said to be functioning already (most people in Cuba, perhaps 80%, own their homes, but lack the right to sell or to buy homes at market-determined prices). If a true market for housing were established, house prices would rise significantly and a new and important use and demand for old pesos would occur, the end result being

downward pressure on the black market exchange rate and a reduction of the structural split in the economy. Legalization of markets for other physical assets would have a similar result.

A second institutional reform which has considerable potential but which would have to be managed carefully would be a process of privatization or cooperativization of existing State-owned assets. This has already been undertaken with a large proportion of State farms and their conversion to cooperatives. There are many State-sector service facilities which operate on a small scale and which already face effective competition from an expanding self-employment sector. Such businesses include State retail shops of various kinds, repair shops, personal services such as beauty parlours or barber shops, small bars, and coffee shops. Privatization of such facilities by their sale to Cuban citizens would make good sense in terms of the quality of the services which would be provided, since State ownership has been least successful in ensuring quality and in adapting to consumer demand in the area of small-scale services. Privatization would also allow the State to acquire significant amounts of old pesos, thereby reducing their supply, driving up their value *vis-à-vis* the U.S. dollar and helping to put more downward pressure on prices of goods and services in old pesos. The revenues acquired by the State would make possible a reduction in the fiscal deficit and reduced monetary emission, all of which would be beneficial for reducing the split between the socialist and internationalized economies.

Privatization of medium- and large-scale enterprises is more controversial and more difficult. The Cuban government is already permitting partial privatizations to foreigners through the establishment of minority foreign ownership of joint ventures, often but not always for new investment projects. Privatization of existing assets to foreigners, even through joint ventures, has its drawbacks, namely the disposal at fire-sale prices of valuable assets and the stream of profits which will be expatriated by the foreign owners in the future. Privatization to Cuban citizens might be more advantageous, but Cuban citizens could not pay U.S. dollars for such assets. Other formulas such as the cooperativization of some of the larger assets to Cuban citizens would be worth exploring, however. Privatization or partial privatization of natural monopolies (such as the sale of 49% of the telephone system to the Mexican firm Domus)

is even more difficult and requires the creation of new public regulatory institutions to prevent the possible abuse of monopoly power.

3. Macroeconomic policy

Cuba's macroeconomic policies, including fiscal, monetary, exchange rate and price control policies, have been of central importance in generating the structural bifurcation of the economy. These complex and contentious policy issues cannot be analysed in depth here. Consequently, only a few comments are put forward to suggest the combinations and designs of policies that are now necessary to heal the bifurcation and to place the macroeconomy on a stable and sustainable trajectory.

The macroeconomic policies introduced so far to deal with the current situation include the fiscal policy outlined in section IV above and the introduction of the "convertible peso." Fiscal policy has been aimed at increasing tax revenues, reducing expenditures, cutting the fiscal deficit and thus reducing the creation of money for financing the deficit and the consequent inflationary pressures. On the basis of the information available so far, it appears that fiscal policy has been quite successful in achieving its objectives: the fiscal deficit has been cut sharply, monetary emission has slowed, and indeed the black market exchange rate and market-determined prices have declined since the tough fiscal measures were introduced (though for other reasons as well). However, the deficit projections for 1995 remained relatively high at around 5 or 6% of GDP (*Granma International*, 1995, p. 4), so that inflationary pressures will continue as long as the deficit can be covered only by creating money, in the absence of a domestic bond market.

The creation and emission of the "convertible peso," introduced in December 1994, is part of a general strategy to replace the "old peso" with one which is convertible, presumably at par, with the U.S. dollar (the well-printed "convertible peso" does not state what it is convertible into, nor at what exchange rate). There is little hope that the convertible peso can become much more than a marginally-utilized currency, and no hope that it can absorb the old peso system and also maintain parity with the U.S. dollar. The Central Bank was able to maintain convertibility of the new peso with the dollar at least up to August 1995, but only because it had been introduced barely

7 months before. It will be difficult to keep the volume issued down to a level which can maintain convertibility with the dollar, for the resources thus acquired at no cost by the government through seigniorage are too attractive to turn down. I would estimate that by early 1996, if not before, the volume of new convertible pesos emitted will be too high to permit their full and immediate redemption for real goods and services in the dollar stores. When this happens, the psychological acceptance of the convertible peso as being as good as the dollar will cease, and people will be unwilling to hold it for store-of-value purposes, preferring the dollar. When that happens, the convertible peso will cease to have the same value as the dollar in the unofficial currency market and it will suffer devaluation *vis-à-vis* the dollar. Cuba will then have a three-currency system with a whole range of new complexities and problems.

What macroeconomic policies could be adopted in order to unify the structure of the economy and improve stability? The following summary of policies is presented as an illustration of the types of policies which need to be analysed, rather than as a set of concrete proposals.

a) *Fiscal policy*

- Fiscal policy aimed at deficit reduction has already begun to be applied, with fairly satisfactory results;
- Further tax increases and/or expenditure reductions are needed to lower the deficit to a sustainable level;
- Alternatives to money financing of the deficit –e.g., bond sales to the public– could be developed;
- Conversion of the current non-tariff barriers into regular tariffs could be a fruitful revenue source over a transitional period;
- State enterprises should set their prices so as to cover their costs as a necessary part of deficit reduction.

b) *Monetary policy*

- Reductions in the rate of emission of “old pesos” are urgently needed for continued anti-inflation purposes;
- Emission of the new “convertible peso” should be very small and aimed only at capturing some “seigniorage” for the government instead of allowing the U.S. dollar to enjoy this benefit;
- Other types of measures are needed to increase the demand for the “old peso” and put downward pressure on prices and the black market

exchange rate. Such measures could include the establishment of genuine markets for housing, cars and other assets; enterprise liberalization as discussed earlier, and general expansion of the role of the market;

- Reduction of the supply of old pesos and measures for increasing the demand for them, so as to lower market-determined prices and the black market exchange rate.

c) *Exchange rate policy*

- Maintenance of the convertibility of the “new peso” at par, by strictly limiting its emission;
- Promotion of actions to increase the use and value of the old peso *vis-à-vis* the dollar in the black market: i.e., to increase the demand for the old peso;
- Unification of the exchange rate immediately, but at the tourist rate level (i.e., all commercial transactions should be carried out at US\$1 = 1 peso rather than US\$1 = 0.74 peso) (the first step should thus be taken in the devaluation process);
- A process of devaluation of the old peso should be begun;
- Measures should be taken aimed at the elimination in 3 or 4 years of the spread between the official and the market-determined exchange rate;
- The “convertible” peso and the old peso should be unified when the official and market-determined rates merge.

d) *Protectionism*

- Most or all of the discrimination in the implementation of (bureaucratic discretionary) protectionism should be gradually eliminated through the ending of the “zero tariff/no NTB” privileges of the “Sociedades Anónimas”; the standardization of tariff rates for all sectors (perhaps with special treatment initially for pharmaceuticals and some foodstuffs), and the replacement of non-tariff barriers with tariffs;
- The adjustment process should begin with high tariff levels (for balance of payments and revenue-raising purposes), to be steadily lowered as the external sector improves and the economy recovers.

e) *Policies on prices and social security*

- Price controls should be phased out quickly wherever they do not affect the cost of the basic set of rationed foodstuffs available;

- The prices of non-food rationed goods should be progressively raised, with the ultimate objective of price decontrol;
- Measures should be taken to move towards a system of income support for needy individuals or families rather than comprehensive untargeted general subsidization of everybody through the rationing system;
- The establishment of a targeted, income-support-oriented social security system should be coordinated with price increases and price decontrols for goods currently rationed (e.g., subsidies currently going to loss-making enterprises producing fixed-price rationed goods should be diverted to provide income support payments for the most vulnerable groups).

In my view, the types of policies listed above are necessary for the unification of the bifurcated economic structure as well as for structural adjustment and ultimate economic recovery. Exchange rate and commercial policy are particularly important from the standpoint of expanding and diversifying exports as well as developing domestic substitutes for goods previously imported. A devaluation of the currently

grossly overvalued exchange rate and the reduction (and eventual elimination) of the extreme discrimination inherent in the current system of protection is vital and urgent if Cuba is to break the tight foreign exchange constraints on its economic recovery. A combination of a continuing tight fiscal policy and an innovative but anti-inflationary monetary policy could assist in increasing the use and demand for the old peso while constraining the increase in its supply. The result of this would be to reduce the black market exchange rate in relative terms, while market-determined prices would probably go down from current levels, thereby also reducing the incentives for resource shifts between the traditional socialist and internationalized sectors to more appropriate levels. It is also very important to modify the social security system to protect those who are hurt by the various policy changes (particularly in price policy), through income support payments rather than the present generalized subsidies to everyone via fixed-price rationed goods. It may be noted that the need for reform of the social security system has already been expressed by the Cuban Minister of Finance, Dr. José Luis Rodríguez (A. Rodríguez Drivet, 1995.)

VI

Summary and conclusions

This essay has analysed the central structural feature of Cuba's economy in the first half of the 1990s, namely, the split between the traditional socialist peso-based component and the internationalized dollar-oriented and marketized component. The origins of this bifurcation lie in i) the rapid expansion of tourism, foreign business (within joint ventures) and the "Sociedad Anónima" conglomerates; ii) pre-1994 macroeconomic policies which produced large fiscal deficits, accelerating expansion of the money supply, rapid inflation in market-determined prices, and extreme devaluation of the old peso *vis-à-vis* the U.S. dollar in unofficial currency markets, while the official rate remained fixed; iii) exchange rate policy and commercial policy which produced extreme discrimination in access to imports, favouring the internationalized sector (especially the "Sociedades Anónimas"), and iv) the general weakness, loss of confidence and contraction of the traditional socialist economy.

This dual currency bifurcation of the Cuban economy has important consequences for the functioning of the economy and society. First, there has been a major impact on income distribution, as those Cubans who have access to U.S. dollars receive considerably higher real incomes, due to the high value of the dollar in unofficial exchange markets, relative to persons working in the traditional socialist economy with incomes in old pesos. This income differential creates an overpowering and universal incentive for resources –most obviously human resources– to be attracted to the internationalized part of the economy. While some reallocation of resources to the foreign-exchange-earning part of the economy is reasonable, the internationalized component is not identical with those activities which earn foreign exchange (e.g., sugar and tobacco) or which produce potential substitutes for imports. The real rewards which society provides to those able to earn or

acquire dollars appear to be out of line with the real value of their contributions to the economy or society. Moreover, this split contributes to pervasive "rent-seeking", as individuals can earn more by arbitraging goods and services across the two economies, playing the differences between fixed and market-determined prices and the official and unofficial exchange rate. Several negative social phenomena have also been worsened by this bifurcation.

A number of public policies introduced since mid-1993 have tended to reduce this bifurcation. The legalization of self-employment and the establishment of agricultural, industrial, artisanal and transport markets have permitted an expansion of the market economy which is in part linked to the internationalized dollar-oriented economy in that market forces determine prices and incomes for the participants. Since 1994, fiscal policy has been quite effective in slowing the process of bifurcation.

A broader array of policies and institutional reforms are required for unification of the economy. Of particular significance would be further liberalization of small- and medium-scale enterprise and certain institutional reforms such as the legalization of markets for housing, continued cooperativization where appropriate, and privatization of small- and medium-scale enterprises of various sorts (especially in retailing and other services). These measures would expand the market economy and would have beneficial macroeconomic effects which could be of major significance in lowering the black market exchange rate and helping move the economy towards a more appropriate general structure of incentives. The area of greatest importance, however, is macroeconomic policy (continued reduction of the fiscal deficit and reduced money creation) plus appropriate exchange rate and commercial policies, all designed to unify the black market and official exchange rates (at perhaps 3 pesos per U.S. dollar?) and to standardize the

system of protection, while eliminating the strong discrimination inherent in its functioning at present. Price decontrol would also be part of such a package of policies, but this would have to be accompanied by the conversion of the current social security system from one of generalized subsidization of everyone (through price controls on rationed commodities) to one of carefully targeted income support measures for those really in need of such assistance.

This broader array of institutional and macroeconomic measures would also provide many of the policy changes needed for successful structural adjustment. The devaluation of the official exchange rate (plus the merging of the unofficial and official rates), together with further liberalization of small- and medium-scale enterprise, standardization of commercial policy and the elimination of discrimination in its application, should permit major expansion and diversification of production for domestic and foreign markets. Such expansion of production for export and for substitution of imports is vital if Cuba's economic recovery is to be sustained and sustainable into the future.

Cuba has only just begun the process of policy and institutional reform needed for the achievement of adjustment, transition and recovery. While the government's caution in the design and implementation of policy changes is laudable, its hesitation to move in a determined manner in a variety of policy areas in the December 1994 to August 1995 period is unfortunate. One cannot help but be awed by the immensity of the task of achieving economic recovery in the context of the extreme deterioration of the capital stock in most areas of infrastructure as well as in industry, agriculture and services, where the existing facilities are environmentally unfriendly, energy-inefficient, internationally uncompetitive and basically obsolete.

(Original: English)

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Transnationalization *and integration of* production *in Latin America*

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Trade among the ALADI countries has grown with exceptional vigour so far in the 1990s, especially in the branches of metal products, machinery and equipment, chemical products, and foodstuffs, beverages and tobacco. In order for this dynamic growth to be sustainable in the long term, these countries must develop their intra-industry trade by promoting reciprocal supply in those branches. The bulk of transnational productive capital in Latin America is concentrated in those branches, and it is in the metal products, machinery and equipment sector that the swiftest increase in intra-industry trade takes place and the link between the growth of intra-regional trade and a strong presence of transnational capital is most marked. In the motor industry –which is a textbook example of these features– the existence of systems and agreements which include elements of preference, and in whose formulation the companies themselves have played a leading role, has been essential for their survival and growth. Examples of this are the rules governing trade in this field between Argentina and Brazil and the areas subject to the regulations governing assembly-type (“maquila”) activities in Mexico. When shaping future strategies for open regionalism and the most suitable arrangements for attracting foreign direct investment without giving rise to an unproductive struggle among the prospective recipient countries, what has been observed in the motor industry suggests that it is not only through economic liberalization but also through special conditions agreed between the firms involved and the members of a given integration scheme that transnational productive capital can be attracted and retained.

I

Introduction

Mutual imports among the ALADI countries, measured as a percentage of their total imports, rose from 10% to 17% between 1990 and 1993. Why did this increase take place, and how sustainable can it be in the long term?

There are increasingly clear indications that these tendencies derive from a more than proportional impact of the elimination of trade barriers among countries which, because of their relative proximity in geographical terms and their greater physical integration, are registering lower and lower transport costs. We could speak of the enhanced overall result of two individual phenomena: the "liberalization effect" and the "economic proximity effect" (Garriga and Sanguinetti, 1994). The impact on mutual trade has been all the stronger because the recent free trade agreements have further accelerated the intra-regional liberalization of the Latin American countries.

Side by side with the free trade agreements, however, systems of exceptions have continued to operate, notably in the case of the motor industry. At the subregional level, mention may be made of Protocol 21 between Argentina and Brazil, while at the hemispheric level there are the export processing zones and the regulations governing assembly-type operations between Mexico and the United States, which continue to apply, at least temporarily, even after the entry into force of MERCOSUR and the North American Free Trade Agreement (NAFTA). The transnational corporations are leading actors in this growth of trade and are reorganizing their intra-regional and intra-hemispheric forms of production specialization in order to take advantage of the economies of scale and of specialization offered by these expanded markets. Although this process does benefit from the general liberalization of markets, its main boost comes from the forms of managed and compensated trade established under the systems of exceptions mentioned earlier.

The influence of the strictly economic elements referred to above is accompanied by that of others which are harder to quantify, such as cultural or language affinity, or the easing of political tensions between neighbouring countries which has been observed with the return to democratic regimes in Latin America.

With regard to the long-term sustainability of the relative expansion of mutual trade, this will depend to a large extent—at least in the strictly Latin American area—on the capacity of regional supply to satisfy the increased Latin American demand for imports inherent in a process of sustained growth. In other words, it will depend on the ability of that supply to evolve towards manufactures or services with a high income-elasticity of demand.

The growth potential of the regional market easily exceeds that of the external markets to which most of the regional supply is directed. The long-term growth capacity of the Latin American economies is a good deal higher than that of the developed countries. In the present conditions of liberalization, however, a definite pattern of intra-industry trade is needed if all the countries participating in a mutual trade scheme are to satisfy their needs with mutual exports and thus stimulate this type of development. Unlike inter-industry trade—which is the typical form of trade between central and peripheral countries—*intra-industry trade* makes possible the sustained growth of trade among countries with more or less similar levels of development and relative factor endowments, through the proper use of economies of scale and specialization.

This role of *intra-industry trade* in Latin American integration and in the encouragement of economies of scale and specialization is not something new for ECLAC. Fully thirty years ago, it noted in this respect that: "Economies of production scale which cannot be enjoyed because of market limitations are of significant importance in major industrial activities connected with the production of consumer durables, capital goods, and basic intermediate products. These economies depend on various factors, such as indivisibility of investments, lack of propor-

□ This article is based on Di Filippo, 1994.

tionality between increased production capacity of plant and the cost of the necessary equipment, and the possibility of incorporating modern technology and some degree of specialization when working at high scales of production". "Regional integration will directly help to solve all these development problems due to market size. In proportion as this process advances, the types of production located in each of the individual member countries will be able to enjoy the potential demand of the entire integrated area. They will consequently be able to set up modern plants with optimum dimensions and suitable levels of specialization, and it will be possible to proceed with industrialization in other branches where this is currently not possible within national markets alone" (ECLAC, 1965).

This view set forth by ECLAC in the mid-1960s has now been modified in two respects. Firstly, economic integration is no longer taking place as part of a process of import substitution industrialization: the aim now is to be compatible with a broad process of opening up to the world economy and to contribute to this. Secondly, intra-industry trade is no longer promoted through sectoral economic complementation agreements, with strong intervention by government bureaucracies in the distribution of production tasks among countries, but now takes place through

the increasingly prominent role of private enterprise (ECLAC, 1994 a and b). Even in those days, however, ECLAC's message was that, in order to be sustainable, the process of trade integration in Latin America needed a more than proportional growth rate of mutual intra-industry trade. Today, this same basic proposal—which came into conflict with the principle of static comparative advantages in vogue at that time—is increasingly confirmed by the most recent academic lines of thought (for example, Krugman and Obstfeld, 1994, chap. 6).

We will give the title "production integration of Latin America" to the establishment of an intra-regional division of labour which makes possible the development of an increasingly diversified supply of industrial products by all the participants. The empirically verifiable expression of the advance of this process of production integration will be the growth of intra-industry trade, not only among the Latin American countries but with the rest of the world as well.

This article provides background information on the leading role played by transnational corporations in the production of the goods—basically metal products, machinery and equipment and chemical products—which currently form the bulk of the intra-industry trade of the Latin American countries.

II

Forms of production integration

In a previous paragraph, we described production integration as the establishment of an intra-regional division of labour which makes possible the development of an increasingly diversified supply of industrial products by all the participating countries.

A first form of production integration is the intra-firm variety, which takes place among subsidiaries of the same transnational corporation. This form is often called "international production" in studies on transnational corporations (UNCTAD, 1993), and gives rise to intra-firm trade in the strict sense.

A second form of production integration is practiced between transnational corporations of developed countries (or their subsidiaries) and local firms to which they subcontract certain production

operations, subject to very precise technical specifications. Here, different types of alliances and agreements are entered into which involve close technical and production links between the transnational subsidiaries and the local subcontractors, and these relationships are known as "new forms of international investment" (Kuwayama, 1992). In the motor industry, the interrelations deriving from these alliances are extremely complex.

Both of the forms considered so far have two features in common: they involve intra-industry trade, and they usually give rise to special trade arrangements with full exemption from customs duties (as in the free zones) or with tariffs calculated only on the basis of the value added to the part or component to be reimported by the original exporter (as in

the case of assembly or “maquila” operations). These special forms of tariff treatment are, on the one hand, a recognition of the fact that what is involved is not trade in the classical (“Ricardian”) sense, while on the other hand they imply mutual preferences which are typical of integration agreements or can promote them. In addition, some of the sectoral agreements currently in force include clear elements of managed or regulated trade. These forms of trade are very frequent between developed and developing countries, and may be de facto forerunners of integration agreements, as in the inclusion of Mexico in NAFTA. They also occur between Latin American countries, involving transnational subsidiaries and local manufacturers of motor parts, as in the case of the agreement on the motor industry between Argentina and Brazil.

The third form of production integration to be examined here was actually the first to be observed in the region, namely, the process of complementation of supply in specific branches of final products, which gives rise to trade in products that belong to the same branch or activity but have different specifications. This type of intra-industry trade was strongly developed, for example, when the countries of the present European Union specialized in very specific

ranges or niches of production within broader branches of manufacturing. All these countries produced machinery, household appliances and transport equipment, for example, but all of different types and quality levels. In this way, they were able to expand their trade in manufactures in a more balanced and dynamic manner, taking advantages of economies of scale and specialization. They were also able to compete in the rest of the world with their products and managed to secure complementary market niches.

This balanced growth did not occur in other important lines of trade in the period since the war. In its early studies, ECLAC clearly highlighted the unbalanced nature of the trade between the central countries and the countries of the periphery, which exchanged primary commodities for manufactures: unbalanced because of the long-term disparities in the growth rates of demand for these two types of products. Nor was it structurally viable to hope to maintain a balance in the mutual trade of countries which were traditional commodity producers, because the lack of diversity—and of diversification—of the exportable supply rapidly sapped the dynamism of such trade.

III

Foreign direct investment and the recipient markets

When an effort is made to identify the links between integration and the behaviour of foreign direct investment (FDI), the inflow corresponding to the transnational corporations already installed in the region immediately stands out. In this respect, estimates corresponding to the early 1990s indicate that the accumulated FDI in the member countries of the Latin American Integration Association (ALADI), at book value, amounted in 1990 to US\$92 billion at current prices, while the inflow in the same year was approximately US\$7.5 billion at current prices (about 8% of the accumulated FDI). Of this total stock of foreign capital, 73% corresponded to Brazil and Mexico (87% if Argentina and Chile are added).

In this section, an attempt will be made to answer a number of questions regarding the links be-

tween the presence of transnational corporations in Latin America and the regional integration process. The generalizations made are based on the analysis of five countries—Argentina, Brazil, Chile, Colombia and Venezuela—which are considered to be fairly representative of the tendencies observed in ALADI. The situation of Mexico—which was left out of this analysis for lack of information—has special features which will be analysed later on, in section VI.

At this point, some of the main questions may be raised. Which are the production sectors that account for the bulk of FDI in Latin America? In which of these sectors does the ALADI market account for a major share of total exports? For which of these sectors has the ALADI market grown faster than markets outside the region?

The answer to these questions is that in the countries in question (except for Chile) half or more of the total FDI is located in the manufacturing sectors, and, within these, mainly in the metal products, machinery and equipment sector (ISIC division 38)¹ and in chemical products (ISIC division 35). The more rapid growth of the ALADI market for these product branches has increased the interest of the transnational corporations in expanding their supply in this direction. For decades past, both branches have received transnational investments in connection with the domestic markets of a number of these countries, and now the transnationals are restructuring their operations to take advantage of the supra-national scale of the markets emerging under the terms of the integration agreements signed in the 1990s.

Another branch of manufacturing which is worthy of mention is foodstuffs, beverages and tobacco (ISIC division 31). Although to a lesser extent, this branch also absorbs a by no means insignificant percentage of manufacturing FDI. Moreover, recent press reports indicate an increase in the presence of big transnationals in this field. The proportion of total exports in this branch absorbed by ALADI is not more than 20% (except in the case of Colombia), but the share accounted for by the regional market is growing faster than total exports in this category.

The weight of these three branches (ISIC divisions 31, 35 and 38) in total exports of manufactures varies considerably from one country to another.

Thus, in Venezuela these branches account for 78% of total exports of manufactures, because of the weight of the petrochemicals industry. In Argentina, they form 70.3% of total manufactured exports, with foodstuffs, beverages and tobacco predominating. In Brazil, they represent 73.1% of such exports, mainly due to exports of metal products, machinery and equipment. In Colombia they account for 42.6% of total exports of manufactures, with chemical products predominating, and finally, in Chile, they form only 21.8% of manufactured exports because that country's main manufactured export line is basic metal industries, where the contribution of FDI is very small and most exports are to countries outside the region (see table 2 below).

The priority attention warranted by these three branches is due to their great capacity for supplying the domestic markets of the countries where such industries are installed. Their present and future competitiveness is supported first of all by the domestic markets themselves and subsequently by the supra-national markets emerging from the present integration agreements, on the basis of which they can launch themselves into the hemispheric or world markets. Consequently, their rate of growth is closely linked with the rate of development of the countries of the region. Although the income-elasticity of demand for foodstuffs with some degree of processing is lower than that of the other two branches, if the region registers sustained growth of the product, together with an improvement in income distribution, the prospects for growth of the foodstuffs, beverages and tobacco branch would nevertheless be quite promising. It is in these three branches that the closest links are to be observed between FDI and Latin American economic integration.

The data presented in tables 1 and 2 below (compiled at the national level) show that, even before the wave of agreements signed in the 1990s, there was a substantial recovery of intra-regional trade as from 1985, when the relative slump in that trade reached its lowest point.

This change in direction of exports was particularly marked in the case of metal products, machinery and equipment and chemical products, where transnational corporations predominate. In the 1990s, the formal entry into effect of integration agreements gave further strength and stimulus to a process which had begun in the second half of the 1980s. The cases of intra-industry trade analysed below confirm that the transnational corporations to some extent anticipated the signing of those bilateral or subregional free trade agreements and began their own process of *de facto* integration either before or at about the same time. Consequently, if there was a growing process of absorption of these products in the ALADI market even before liberalization became a general phenomenon, it is easy to understand the rapid growth of this trade as a result of the implementation of the policies which are being applied in the 1990s.

¹ United Nations International Standard Industrial Classification (ISIC), Statistical Papers, Series M, No.4, Rev.2.

IV

Analysis of national case studies

In this section, we will look at five Latin American countries –Argentina, Brazil, Chile, Colombia and Venezuela– in order to determine the branches which have received most FDI (table 1), the main destinations of the exports of those branches, and the branches which have grown most rapidly in the ALADI market (table 2).

This analysis was carried out as follows. An analysis was made of the branches corresponding to ISIC divisions that absorbed more than 5% of the FDI in the production of goods, and within them two major groups were distinguished. On the one hand, there were the branches which accounted for the bulk of the manufacturing FDI, much of whose production goes to the ALADI market. These branches were chemical products and metal products, machinery and equipment (ISIC divisions 35 and 38). On the other hand were the other primary or manufacturing branches, with proportions of foreign capital which varied according to the countries and with exports directed mainly to markets outside the region. Within this second group, in which natural-resource-intensive activities predominate, there are some branches (such as foodstuffs, beverages and tobacco) which receive a growing share of FDI and are increasing their penetration of the ALADI market.

1. Argentina (1985-1989)

Up to the end of 1993, there were no more recent estimates for this country, broken down by branches of economic activity, which could be compared with the export data. In 1989, 18.8% of total FDI in the production of goods was concentrated in the primary sector. If other natural-resource-intensive manufacturing activities are added to this figure, this gives a total of 35%, and 70.3% of all exports came from these branches. Moreover, some 70% of the exports in question went to destinations outside the region.

The branches corresponding to ISIC divisions 35 and 38 received 49.6% of total FDI and produced 19% of all exports of goods, while 42% of the total exports of division 35 and 55% of those of division 38 went to the ALADI market.

Total exports of the chemical products and metal products, machinery and equipment branches increased by US\$260 million, while exports to ALADI rose by US\$376 million. Of the overall increase in Argentina's total exports of manufactures, 32% was due to exports by these two branches to ALADI.

2. Brazil (1985-1991)

Of the total FDI in the production of goods accumulated by the end of this period, only a meagre 4.3% corresponded to the primary sector, thus highlighting the fact that in that country export agriculture is fundamentally in Brazilian hands. If FDI in some natural-resource-intensive manufactures is added to this figure, this gives a total of 23.3%. The percentage of total exports corresponding to these branches was 55.3%, while exports to destinations outside the region came to between 79% and 94% of the total, depending on the branch in question.

The chemical products and metal products, machinery and equipment branches accounted for 65% of total FDI in the production of goods. The exports of these two branches represented 32% of total exports of goods, went to more diversified destinations, but the proportion of sales to ALADI was not particularly high.

In terms of export growth, however, the ALADI market has been vital for the expansion of these branches. The net increase in total exports for the two branches in question was US\$1 155 million, while the increase in sales to ALADI came to US\$1 690 million and made up for the decline in exports to markets outside the region (Di Filippo, 1994). The increase in exports to ALADI in the case of these two branches was not only US\$535 million more than the growth of exports to the world as a whole but also generated 54% of the overall increase in Brazil's total exports of manufactures to the world as whole during the period.

3. Chile (1985-1990)

In Chile, 78% of total FDI in the production of goods was concentrated in the primary sector. There is little presence of transnationals in natural-resource-

TABLE 1

Latin America (five countries): Foreign direct investment,
by countries and sectors

(Millions of current dollars and percentages)

Country	Total	Primary sector	Foodstuffs, beverages and tobacco	Textiles and leather products	Paper and paper products	Non-metallic minerals	Basic metal industries	Chemical products	Metal products, machinery and equipment	Other
Argentina (1989)										
FDI in production of goods	51 636	973.3	5 502.0	2 001.0	324.0	1 764.0	2 888.0	12 003.0	13 663.0	375.9
Percentages	100.0	18.8	10.6	3.8	0.6	3.4	5.6	23.2	26.4	7.3
% of growth (1985-1989)	4.1	3.1	14.3	22.5	0.8	5.5	0.9	0.5	1.1	10.6
Brazil (1991)										
FDI in production of goods	273 350.0	1 179.2	21 082.0	8 224.0	8 730.0	6 384.0	31 079.0	79 176.0	98 477.0	810.6
Percentages	100.0	4.3	7.7	3.0	3.2	2.3	11.3	28.9	36.0	2.9
% of growth (1985-1991)	35.6	21.1	28.0	32.6	58.8	47.0	60.7	48.0	25.0	5.0
Chile (1990)										
FDI in production of goods	4 438.4	34 980.0	2 094.0	154.0	1 010.0	772.0	9.9	251.6	1 283.0	40.3
Percentages	100.0	78.8	4.7	0.3	2.2	1.7	0.2	5.6	2.9	0.9
% of growth (1985-1991)	172.2	233.4	35.6	79.6	106.2	15.7	17.5	24.5	51.8	436.0
Colombia (1991)										
FDI in production of goods	3 289.9	1 638.6	231.8	646.0	186.8	89.7	17.0	6 316.0	4 088.0	208.0
Percentages	100.0	49.8	7.0	1.9	5.6	2.7	0.5	19.2	12.4	0.6
% of growth (1985-1991)	75.4	119.0	46.3	30.3	55.3	39.1	(-1.6)	27.9	97.2	35.0
Venezuela (1991)										
FDI in production of goods	3 426.2	1 886.0	561.8	42.8	158.3	210.7	313.4	11 960.0	7 469.0	73.0
Percentages	100.0	5.5	16.4	1.2	4.6	6.1	9.1	34.9	21.7	0.2
% of growth (1985-1991)	190.5	385.1	106.1	106.3	305.1	240.1	244.7	132.5	272.9	(-43.7)

Source: Prepared by the author on the basis of official figures.

TABLE 2

Latin America (five countries): Exports by sectors, by destination

(Millions of current dollars and percentages)

	Total exports	Primary sector	Foodstuffs and beverages	Textiles and leather products	Paper and paper products	Non-metallic minerals	Basic metal industries	Chemical products	Metal products, machinery and equipment	Other industries	Secondary sector
Argentina (1985-1989)											
Total (1989)	9 565.2	2 138.9	3 411.5	772.6	178.1	75.8	1 171.0	1 092.1	711.5	104.0	7 422.9
Destination: ALADI (%)	24.9	26.6	13.7	17.0	50.4	56.4	17.6	41.7	55.4	56.4	24.6
Destination: U.S.A. (%)	12.3	6.3	-	31.6	12.7	16.4	15.3	20.6	10.6	27.8	14.1
Destination: Rest of world (%)	62.8	67.1	86.3	51.4	36.6	27.2	67.1	37.7	34.0	15.5	61.3
<i>Growth in exports (%)</i>											
Total	13.9	(-365)	42.8	41.0	194.2	381.4	150.0	10.7	27.9	494.2	47.8
To ALADI	60.8	9.2	81.2	68.1	164.0	390.6	137.0	43.4	125.8	866.3	87.7
To U.S.A.	15.3	91.7	2.3	136.2	167.4	719.4	94.6	(-43.3)	1.0	347.6	9.7
Brazil (1985-1991)											
<i>Exports</i>											
Total (1991)	25 593.9	3 823.5	7 658.0	2 065.4	882.6	174.2	2 685.8	3 810.5	4 443.2	47.7	21 767.6
Destination: ALADI (%)	8.7	4.7	0.8	5.8	10.5	30.4	7.5	12.9	20.5	22.2	9.4
Destination: U.S.A. (%)	27.1	9.6	24.0	56.7	26.4	35.8	24.7	30.5	32.1	35.0	30.2
Destination: Rest of world (%)	64.2	85.7	55.2	37.5	63.1	33.8	67.8	56.6	47.4	57.2	39.6
<i>Growth in exports (%)</i>											
Total	23.5	67.2	(-38.1)	31.6	122.5	76.2	113.1	(-23.4)	46.2	148.7	14.3
To ALADI	121.8	94.5	3.5	115.3	151.5	109.5	201.6	88.2	137.5	653.0	124.2
To U.S.A.	(-8.4)	124.4	(-67.9)	(-2.1)	69.5	0.3	17.3	(-43.7)	32.2	307.0	(-15.9)
Chile (1985-1990)											
<i>Exports</i>											
Total (1990)	8 521.7	2 363.4	827.1	112.9	668.5	23.5	3 910.5	365.2	124.3	11.2	6 043.6
Destination: ALADI (%)	11.9	13.9	14.5	24.0	22.8	14.4	4.4	41.3	40.5	36.6	11.2
Destination: U.S.A. (%)	16.7	22.6	12.9	50.3	7.6	64.6	13.6	21.0	36.5	39.2	14.7
Destination: Rest of world (%)	71.4	63.5	72.6	25.7	69.6	11.0	82.0	37.7	23.0		
<i>Growth in exports (%)</i>											
Total	138.2	121.7	82.2	1 169.3	101.3	1 343.7	147.3	159.2	220.6	5 312.5	140.8
To ALADI	92.2	167.5	216.9	3 064.2	52.4	387.2	(-11.2)	255.7	185.4	9 015.6	67.9
To U.S.A.	88.0	96.9	43.2	2 668.0	(-8.7)	1 692.4	49.3	292.9	419.4	7 354.7	82.8
Colombia (1985-1991)											
<i>Exports</i>											
Total (1991)	7 268.5	4 171.4	316.6	1 014.1	197.8	124.0	195.5	711.7	268.5	211.2	3 039.5
Destination: ALADI (%)	15.2	6.7	36.6	13.8	41.4	39.8	10.3	38.7	43.0	8.1	26.8
Destination: U.S.A. (%)	38.3	42.7	13.8	37.9	42.0	35.8	13.3	39.4	17.7	23.9	32.5
Destination: Rest of world (%)	46.5	50.6	49.6	48.3	16.6	24.4	76.4	21.9	39.3	68.0	40.7
<i>Growth in exports (%)</i>											
Total	107.9	84.6	91.3	469.6	138.1	234.8	183.7	19.3	287.4	606.5	145.8
To ALADI	294.1	383.0	543.1	208.9	150.3	603.6	3 470.0	269.2	218.1	413.7	266.7
To U.S.A.	142.9	171.0	(-9.6)	343.0	186.9	124.4	86.7	13.8	355.1	2 119.3	101.6
Venezuela (1985-1991)											
<i>Exports</i>											
Total (1991)	14 776.5	7 877.4	180.3	64.9	62.2	115.1	1 269.3	4 949.8	247.7	9.0	6 898.4
Destination: ALADI (%)	7.8	4.4	14.1	14.6	9.2	9.4	19.1	8.8	27.1	26.6	11.6
Destination: U.S.A. (%)	52.7	61.3	13.0	32.6	22.2	43.1	20.0	50.3	42.1	51.1	42.9
Destination: Rest of world (%)	39.5	34.3	72.9	52.8	68.1	47.5	60.9	40.9	30.8	22.3	45.5
<i>Growth in exports (%)</i>											
Total	(-7.8)	(-0.1)	97.6	600.9	-1.7	(-38.2)	(-31.6)	(-14.3)	54.8	458.5	(-15.2)
To ALADI	61.3	(-5.6)	143.6	7 867.2	49.8	10 141.1	218.2	91.0	186.8	489.0	133.5
To U.S.A.	7.8	56.1	(-38.2)	254.2	(-61.7)	(-65.0)	(-6.0)	(-76.1)	29.8	444.9	(-28.3)

Source: Prepared by the author on the basis of official figures.

intensive manufactures, while the foodstuffs, beverages and tobacco branch received some 5% of FDI. These two branches (primary commodities + foodstuffs) accounted for 37.4% of total exports of goods. In neither case did exports to ALADI represent more than 15% of the total.

The most important branch in terms of exports of manufactures was basic metal industries, which received only an insignificant percentage of FDI but accounted for over 60% of exports of manufactures. The total exports of this branch increased by US\$3 230 million, but those directed to the ALADI market went down by US\$21 million; the Latin American region absorbed less than 5% of the total and showed little dynamism.

The ALADI market grew a little more in the case of foodstuffs, beverages and tobacco, where total exports increased by US\$418 million (82%) and exports to ALADI grew by US\$82 million (216%).

The chemical products and metal products, machinery and equipment branches behaved quite atypically compared with the other countries analysed. The first-named branch absorbed less than 6% of total FDI and the last-named one less than 3%. Although they did not reach the threshold level of 5% adopted in this article, they have been included in the analysis because of their strategic role in all industrialization processes. Their respective shares in total exports were also small (4.2% and 1.5%). However, the ALADI market was the most important one for these branches, absorbing over 40% of their exports.

We thus see that these two branches had little weight (less than 4%) in the increase in Chile's exports of manufactures (this meagre figure may be compared with 54% for Brazil, 32% for Argentina, or even 16% for Colombia). Nevertheless, in the course of the period the chemical products branch increased its total exports by US\$224 million (159%), while its exports to ALADI grew by US\$108 million (256%).

4. Colombia (1985-1991)

In this country, total FDI in the production of goods has been strongly concentrated in the primary sector (50%). If natural-resource-intensive activities which receive more than 5% of the total FDI in goods production are added to this, the figure rises to 62.4%. Exports from these branches represented 64% of total exports of goods.

The ALADI market absorbed only a very small proportion of the exports of the primary sector proper, but it received a substantial share of natural-resource-intensive manufactures.

The branches corresponding to ISIC divisions 35 and 38 absorbed 31.6% of FDI, and their exports represented 13.3% of total exports. ALADI is a very important market for these exports, of which it absorbs some 40%.

The most important export manufacturing branches were leather products and textiles, which accounted for 33.4% of total manufactured exports, but as they only received 2% of total FDI they were not included in the figures referred to in the previous paragraph. The main market for these branches was not Latin America but the European Union, followed by the United States.

The Colombian chemical products branch behaved like the corresponding branches in Argentina and Brazil in terms of the destination of its exports. Total sales to the world as a whole increased by US\$115 million (19.3%), while those to the ALADI market grew by US\$201 million (269.2%). In the case of the metal products, machinery and equipment sector, total exports rose by 287%, while those to the ALADI market grew by 218%.

5. Venezuela (1985-1991)

In 1991, the Venezuelan primary sector only received 5.5% of total FDI. If the share of natural-resource-intensive branches of manufacturing is added to this, the figure rises to 37%. Altogether, these areas of activity generated 64% of total exports of goods, but in none of them was the share of the ALADI market greater than 20% of total exports.

In the branches of manufacturing corresponding to ISIC divisions 35 and 38, chemical products absorbed 34.9% of total FDI, while metal products, machinery and equipment accounted for 21.7%, making a total of 56.6% of FDI in the production of goods. In contrast with the branches referred to earlier, the main destination of these two branches was the United States, which absorbed 50.3% of total exports of chemical products and 42.2% of total exports of metal products, machinery and equipment.

The growth trends of the ALADI market for these branches were similar to those observed in the case of Argentina and Brazil, however. Total exports of manufactured chemical products went down by

US\$823 million, which was only partly offset by the increase of US\$209 million in exports to ALADI. Exports of metal products, machinery and equipment, for their part, grew by US\$88 million (55%), while exports of these goods to ALADI grew by US\$44 million (187%), thus accounting for 50% of the growth in exports in this branch.

Thus, although their absolute and percentage weight is only quite small, these two branches found a more dynamic market in ALADI than in the rest of the world. Indeed, even at a more general level, the exports of the branches accounting for most of total FDI grew more in the case of the ALADI market than in other world markets.

V

Integration, transnational corporations and intra-industry trade

This section presents information which supports the argument that intra-industry (Grubel and Lloyd, 1975) and intra-firm trade, especially in the metal products, machinery and equipment branches, is one of the main driving forces for the expansion of mutual trade among the large and medium-sized countries of South America. It also emphasizes, however, that in order to be sustainable this expansion process needs mechanisms to promote and balance that trade. In view of the leading role of the transnational corporations in these branches, the use of sectoral economic complementation agreements can be a fundamental mechanism for sustainable expansion. In the paragraphs below, an analysis is made of trends in intra-industry trade between pairs of countries in the branches which have received most FDI, and special reference is made to the agreement between Argentina and Brazil on the motor industry.

1. Intra-industry trade between Argentina and Brazil

A good example of the foregoing is the recent evolution of intra-industry trade between Argentina and Brazil (table 3). This example is very significant because the bilateral trade link between these two countries is the most important of all the ALADI trade flows and is, of course, the basis for the expansion of MERCOSUR. The two branches of manufacturing which absorb most FDI are chemical products and metal products, machinery and equipment. The share of the first-named of these in overall mutual trade has been going down, but the share of the second has significantly increased.

Thus, in 1984 the share of this second branch in bilateral trade was 15%, but in 1991 it had risen to 26%: the most rapid growth observed at this level of disaggregation. This branch was also one of those which most significantly increased its coefficient of intra-industry trade: from 30.9% in 1984 to 63.2% in 1990 (Lucángeli, 1992 and 1993; Di Filippo, 1994).

A high and growing coefficient of intra-industry trade is a necessary, but not of itself sufficient, condition for the sustainable expansion of mutual trade. Thus, for example, in the chemical products branch the coefficient of intra-industry trade between Argentina and Brazil rose from 18.2% in 1984 to 67% in 1990, but over the same period the share of this branch in total trade between those two countries went down from 18.7% to 11.7%.

2. Intra-industry trade between Colombia and Venezuela

In both Colombia and Venezuela, the two branches of manufacturing which have received most FDI are chemical products and metal products, machinery and equipment. Trade in these two branches between these countries forms the bulk of their bilateral trade in manufactures, but the share of the first branch has increased, whereas that of the second has declined.

Thus, the share of metal products, machinery and equipment in mutual trade between the two countries went down from 20.1% to 11.3% between 1981 and 1988, but its coefficient of intra-industry trade rose from 37.9% to 94.2%.

Over the same period, the share of the chemical products branch rose from 21.2% to 48.6%, while its

TABLE 3

Argentina and Brazil: Mutual trade in significant product groups, 1990^a
(Thousands of current dollars)

SITC/Rev.2 groups	Total trade	Intra-industry trade	Coefficient of intra-industry trade	
511	Hydrocarbons, n.e.s.	33 358	29 048	87.1
512	Alcohols, phenols and their derivatives	34 467	23 502	68.2
513	Carboxylic acids and their derivatives	19 275	11 028	57.2
514	Nitrogen-function compounds	21 097	15 914	75.4
515	Organo-inorganic compounds	20 681	18 508	89.5
522	Inorganic chemical elements	37 054	14 442	39.0
523	Other inorganic chemicals	18 119	7 956	43.9
531	Synthetic organic dyestuffs	5 669	3 046	53.7
582	Condensation products	11 212	8 792	78.4
583	Polymerization products	39 930	36 378	91.1
591	Disinfectants, insecticides, fungicides, etc.	19 464	15 364	78.9
598	Miscellaneous chemical products, n.e.s.	15 080	13 478	89.4
625	Rubber tyres	19 375	17 396	89.8
641	Paper and paperboard	32 159	27 508	85.5
652	Cotton fabrics	5 677	1 812	31.9
674	Universals, plates and sheets	19 720	13 302	67.5
684	Aluminium	9 597	8 678	90.4
695	Hand tools	12 317	4 176	33.9
713	Internal combustion engines	37 638	29 346	78.0
723	Civil engineering plant and equipment	10 222	7 292	71.3
728	Other machinery and equipment, specialized	9 296	4 396	47.3
741	Heating and cooling equipment	7 075	6 950	98.2
742	Pumps for liquids	11 444	8 684	75.9
743	Pumps and compressors	16 553	16 066	97.1
745	Other non-electrical machinery and tools	16 774	12 292	73.3
749	Non-electrical parts and accessories of machinery	16 120	11 762	73.0
752	Electronic data processing equipment (computers)	10 961	8 624	78.7
772	Electrical switchgear and equipment	5 161	2 516	48.8
775	Household appliances	5 849	4 984	85.2
778	Electrical machinery and apparatus, n.e.s.	14 467	11 468	79.3
784	Motor vehicle parts and accessories	96 297	90 286	93.8
882	Photographic and cinematographic supplies	16 952	6 472	38.2

Source: Lucángeli, 1992.

^a These "significant groups" correspond to SITC three-digit groups which registered a coefficient of intra-industry trade over 30 and total trade worth over US\$5 million.

coefficient of intra-industry trade rose from 61.1% to 90.3% (Fuentes and Jaramillo, 1993).

3. Intra-industry trade between Mexico and Colombia

Trade between Mexico and Colombia has evolved in a similar manner to the preceding case, but in more extreme terms. In Mexico and Colombia, too, the two branches of manufacturing which received most FDI were chemical products and metal products, machinery and equipment.

The share of chemical products in total mutual trade in manufactures was 41% in 1981 and 77% in 1988. The respective coefficients of intra-industry trade were 11.7% and 13.4%, with a big trade imbalance against Colombia.

The share of the metal products, machinery and equipment branch in mutual trade in manufactures went down from 25.6% to 7.1% over the period in question, and the respective coefficients of intra-industry trade went down from 38.4% to 10.4% (Fuentes and Jaramillo, 1993).

4. Intra-industry trade and sectoral agreements: the motor industry in trade between Argentina and Brazil

The growth of mutual trade in a given branch may be accompanied by a decline in the coefficient of intra-industry trade, if the bilateral balance in that trade is upset. When this happens, the existence of sectoral economic complementation agreements may help to find balancing mechanisms that make possible sustainable growth in the long term. This is what seems to be happening between Brazil and Argentina in the metal products, machinery and equipment branch (ISIC division 38), especially in the case of the motor industry. The presence of transnational corporations seems to have played a key role in this process.

In the following paragraphs, we shall carry out an analysis at the SITC three-digit level,² covering 32 groups which in 1990 registered a coefficient of intra-industry trade over 30 and total trade over US\$5 million (table 3). These groups accounted for two-thirds of total trade in manufactures. In the automobile parts group, where most of the capital is transnational, the coefficient of intra-industry trade was 93.8. Other groups with high coefficients were internal combustion engines and tyres.

In 1991-1992 these coefficients of intra-industry trade suffered a decline attributable to the growing imbalance in trade in manufactures between Argentina and Brazil. The biggest drop in the coefficient (by

half) was in the metal products, machinery and equipment branch. This may be because in 1990 the motor industry had total trade of around US\$150 million, of which US\$120 was intra-industry trade. In 1991, trade in this branch trebled, but its index of intra-industry trade went down to 69 because Brazil's exports to Argentina grew much more than those of Argentina to Brazil.

In 1992 the motor industry trade imbalance became even more marked, and the coefficient slumped to only 40, with Brazilian exports worth US\$900 million to Argentina, but only US\$250 million in the opposite direction. More recent data from the same source –given in the Buenos Aires periodical *El Economista* on 22 April 1994– indicate a substantial trend towards a recovery in the trade balance between Argentina and Brazil, with a rise in the indexes of intra-industry trade. Thus, in the case of trade in manufactures in general, the coefficient stood at 50, which was very close to the peak value in the series, reached in 1990, while in the case of the motor industry the coefficient rose from 40 in 1992 to 76 in 1993. This recovery may be attributed to two main factors: first, the need to fulfil the commitments under the motor industry agreement between the two countries (an example of the important balancing role that sectoral economic complementation agreements can play), and second, the expansion in Brazilian demand for motor vehicles (Lucángeli, 1992 and 1993; *El Economista*, 1994).

VI

Promotion policies aimed at the transnational corporations

Generally speaking, it may be said that the effective competitiveness of a firm stems both from its own competitive advantages and from the surrounding conditions of a local and national nature determined by the country in which it is located (Porter, 1991; Dunning, 1993).

It is important to distinguish between these two sources of competitiveness, because of their different impacts on policy formulation. Thus, policies designed to encourage foreign investment will tend to concentrate on the creation of advantages of location, while policies aimed at promoting the internationalization of local firms must seek both to create advantages of location and to generate specific advantages of the firms themselves.

In short, the effective competitiveness of a firm will depend on its specific competitive advantages or

² United Nations Standard International Trade Classification, Statistical Papers, Series M, No. 34/Rev. 2.

inherent advantages (Dunning, 1993) and on the advantages of location due to the place where it is located. When a transnational corporation decides to establish itself in a given host country, it brings with it its own inherent advantages and expects to receive the advantages of location from the host country. Thus, countries must discover or create their own advantages of location to make them interesting to the countries which they selectively wish to attract. In this case, in addition to establishing sectoral restrictions on the least desirable types of capital, the selectivity mechanisms should seek to create advantages of location specially designed to attract the most desirable branches.

1. Export processing zones

The most direct way in which the governments of developing countries have tried to create advantages of location is through the establishment of export processing zones. With this aim, advantages of location for export-oriented manufacturing or assembly firms are created in a geographically limited area which is given extraterritorial status with respect to the rest of the country. These areas usually include installations and buildings which are offered for sale or lease to the firms in question. The set of special incentives offered for such firms includes tax and tariff exemptions; freedom from foreign exchange controls; exemption, automatic delivery or rapid processing of all types of government permits or formalities, including the granting of visas to foreign executives and managers; flexibility –or different rules– in respect of the application of labour laws; authorization to establish 100% foreign-owned firms; provision of physical, energy and communications infrastructure of higher quality than the national average or specially designed for certain production requirements, etc.

Around 75% of the export processing zones which exist in the world are devoted to the production of textiles, clothing or electronic goods, which are among the most dynamic activities in world trade.

The branches of production thus installed gradually increase their technological content as the export processing zones become more firmly established. Ultimately, some of these zones have been improving their telecommunications infrastructure in order to create advantages of location for data

processing or computer-based activities (Jamaica, Dominican Republic and Costa Rica) or have even set up research and development installations (Taiwan, Singapore and South Korea).

Although these zones have not been developed to a very great extent in the ALADI countries, they have grown spectacularly in Mexico, Central America and the Caribbean, where they are an increasingly important element in the economy. In Mexico, which is the ALADI country where export processing zones have acquired the greatest importance, the assembly-type (maquila) activities which have grown up thanks to the preferential tariff arrangements granted by the United States now generate 41% of total exports, the corresponding figures being 30% in the case of Jamaica and 68% in the case of the Dominican Republic.

Strictly speaking, the installation of such zones means the creation of an extraterritorial enclave which, in principle, can benefit the host country through the generation of foreign exchange, the direct creation of jobs, the incorporation of foreign capital and advanced technology, or the training of local labour. The creation of linkages between the export processing zone and the rest of the national economy is often frustrated, however, by the fact that there is little or no capacity to spread these activities to the rest of the country.

Clearly, although this form of promoting FDI contributes to globalization, liberalization or even the development of hemispheric preferences (as in the relationship between Mexico and the United States), it is hard for it to spread its benefits to the rest of the national territory, and still less to promote regional integration among the other ALADI economies.

Transnational corporations prefer to set up operations in export processing zones when these offer them two types of advantages of location: first, lower costs of labour, energy or other factors or inputs, and second, proximity to a major centre of consumption, which reduces transport costs for reaching it and thus increases competitiveness. When firms located in an export processing zone enjoy tariff preferences for entering such a major market –as in the case of the special maquila arrangements granted to Mexico by the United States– the advantages of location increase enormously for the firms installed there. However, the aim of these firms is not to integrate themselves systemically into the production structure of the host country, because they prefer their special

extraterritorial status. They are only interested in taking advantage of very specific advantages of location as part of strategies designed to maximize their profitability within their own value-added chains.

In Latin America and the Caribbean, the importance of export processing zones is to be seen at the hemispheric level in the case of NAFTA, of which Mexico is already a member, or the preferential trade regimes that the United States has set up with Central American and Caribbean countries. These preferential trade arrangements call for two comments. First, they involve a significant component of managed trade, previously negotiated with the transnational corporations and designed to foster intra-industry trade, and second, they raise some queries regarding the benefits these agreements bring for the local firms participating in them. These two comments may be illustrated by examples taken from the functioning of maquila activities in the Mexican motor industry.

Since the end of 1989, the Mexican authorities have done away with all restrictions on imports for the automobile parts industry, but in order for automobile manufacturers to import finished vehicles they must export vehicles or components of equivalent value. As we can see, this rule directly favours the growth of intra-industry trade and, within this branch, intra-firm trade in particular. In 1991 motor assembly firms were allowed to import new vehicles provided they could show that they had a surplus in their international trade, thus introducing a mechanism which is hardly compatible with the provisions of the Uruguay Round on trade-related investments. However, the position of the transnational corporations was strengthened by the decision to permit 100% foreign ownership of automobile part firms.

These are some examples of the managed nature of the motor industry agreements between Mexico and the United States. Thanks to these direct regulations, however, the index of intra-industry trade in the motor vehicle and motor vehicle parts industries, taken as a single sector, has reached extremely high levels. The signing of NAFTA has not brought about the liberalization of this sector; instead, the validity of these agreements has been extended for almost a decade.

The Mexican automobile parts firms involved in this process are showing some concern. To begin with, they are impeded in their search for new export markets, because the agreements which have been

signed oblige them to export through their transnational partners who provide the technology. Secondly, as NAFTA enters fully into operation this opens up the possibility that the owners of the technology will prefer to produce in the United States—due to domestic trade union pressures or other reasons, for example—and to export directly to Mexico, thus liquidating the Mexican motor parts firms which are totally dependent on that technology. Thirdly, they fear the competition of the United States transnationals themselves: General Motors has 26 assembly plants in Mexico and plans to open others (Mattar and Schatan, 1993, p. 111 *et seq.*).

In the other ALADI countries—that is to say, the South American countries—the existence of export processing zones could have a negative effect on the progress of subregional integration schemes. Even assuming that the products of such zones are considered as coming from outside MERCOSUR or the Andean Group, their geographical proximity to those groups will increase their competitiveness because of the lower transport costs of the firms located there, which “export” within those areas. The fundamental aim of schemes like MERCOSUR or the Andean Group should be to harmonize and coordinate their members’ rules on foreign investment, so that firms will set up operations and establish commitments within the expanded markets. In this way, the host countries will be able to take full advantage of all the externalities deriving from the entry of these firms: an objective which is partly frustrated when the firms decide to establish their plants “on the margin” of those areas in order to increase the trading competitiveness of their exports to markets which, thanks to the integration processes, are increasing in size and dynamism.

In order to prevent the establishment of export processing zones from becoming too much of a temptation for the least industrially developed countries in certain subregional schemes, the most highly developed members must formulate and adopt measures to support the participation of all members in an integrated form of industrial development based on intra-industry trade (Paes Saboia, 1993). Such support could be provided through cooperation in the establishment of infrastructure or industrial parks which would permit the creation of some advantages of location, together with sectoral economic complementation agreements to promote, among other objectives, technical training and financial backing.

2. Special arrangements. The motor industry in Argentina

In contrast with the examples given above, which present a hemispheric projection, in the Southern Cone of Latin America transnational corporations are making a decisive contribution to the expansion of intra-regional trade.

Within MERCOSUR, among the activities where there is heavy participation by transnational corporations, the motor industry of Argentina and Brazil is also subject to an agreement set forth in Protocol 21. Before we consider this matter, mention should be made of the regulations in force in Argentina for the motor industry, which are directly connected with that agreement.

As from 1991, and with a period of validity extending up to 1994, a set of regulations on the motor industry was adopted in Argentina which also applies to the transnational corporations operating in this sector, some of them in association with local capital. These regulations stipulate, among other things, the following: i) given maximum proportions of imported content for products manufactured in the country; ii) compensated trade commitments subject to annual or multi-annual programmes; and iii) minimum obligatory levels of content of products of the automobile parts sector, regardless of the annual exports of the terminal firms.

These rules match others in the motor industry agreement between Brazil and Argentina (Protocol 21), in which bilateral trade is regulated on the basis of company-level integrated programmes, with mutual trade quotas for vehicles and parts and exemption of this trade from customs duties. The aim is to secure balanced mutual trade and complementation of production in this area of activity: i.e., the expansion of intra-industry trade in the sector.

As in the case of the relationship between Mexico and the United States, these rules do not appear to be compatible with the recent agreements of the Uruguay Round on trade-related investment measures, which stipulate that foreign and domestic investors must be treated in the same manner and that all quantitative restrictions on trade—such as the obligation to export a given quota of production or to use domestic inputs—must be eliminated.

With regard to the rules on the motor industry, a recent study on this sector from the standpoint of the Argentine economy (Chudnosky, López and Porta,

1994, pp. 37-39) states that: “The export performance of the motor industry is the result of the sectoral regulations in force since 1991. For the terminals, the incentive to keep on producing lies in maintaining their leading position in the Argentine market. Thus, it is generally agreed that if imports had been completely liberalized in this sector, local production of finished vehicles would have practically disappeared (or would only have persisted in the form of assembly activities). If this had happened, much of the market now supplied by the terminals installed here would have been taken over by other producers, especially from Asia. Although the firms concerned have worldwide trading networks that could supply the Argentine market with vehicles from other subsidiaries manufactured at lower cost, the higher cost of local production is more than offset by a market share much higher than they would have in a system of supply based on imports. This appraisal of the situation is borne out by the fact that two of the terminals are controlled by Argentine associates who are obviously prevented from supplying the local market from other locations. In fact, the sectoral regulations in force not only secured the continued operation of the existing terminals but also encouraged the return of a United States terminal which had withdrawn in the late 1970s and aroused the interest of several Japanese motor firms which have announced plans to set up plants in the country”.

With regard to the impact of the existence of MERCOSUR on this system, the same study says: “It is important to note that MERCOSUR is functional for this industry in Argentina only as long as a special system of managed trade persists; in other words, it is not the general programme of tariff reductions for intra-area trade which is the key factor, but the sectoral scheme governing trade between Argentina and Brazil”.

What is needed, then, is to strike a reasonable balance between respect for the most recent rules of the Uruguay Round on trade-related investments and the industrial policy mechanisms which have shown themselves to be of decisive importance for promoting trade among the ALADI countries. Obviously, the idea is not to keep up hidebound forms of protectionism by force, but to avoid the premature adoption of liberalization measures which would prevent the firms already installed in the region from recovering their competitiveness and would be fatal for such important industrial branches as those referred to in our example.

VII

Summing-up

By way of a brief summing-up of some of the basic findings of this study, we may highlight the following points:

Trade among the ALADI countries has grown with exceptional vigour so far in the 1990s. This greater vigour already began to be noted in the second half of the 1980s, in the form of a gradual increase in the share of ALADI in the exports of the member countries of that scheme. The most dynamic branches have been metal products, machinery and equipment (ISIC division 38), chemical products (ISIC division 35) and foodstuffs, beverages and tobacco (ISIC division 31).

It is in these same branches that most of the transnational productive capital in Latin America is located. Of the three, however, it is in the metal products, machinery and equipment branch –and especially in the motor industry– that the link between the growth of trade among the ALADI countries and the strong presence of transnational capital is most marked. Something similar has occurred in the case of Mexico, but at the level of intra-hemispheric trade, with regard to the structure of its exports to the United States.

In the motor industry, which is the clearest example of the above-mentioned features, there is a very noticeable presence of arrangements and agreements which go far beyond mere trade liberalization and include a major element of preferential trade which comes very close to the limits of the multilateral trade rules accepted by GATT or even perhaps oversteps them. Thus, these arrangements are not restricted to the promotion of levels of mutual trade liberalization which exceed the corresponding global levels, but

actually include explicit forms of protection of the activities of transnational corporations and trade flows regulated by the agreements in question: for example, by demanding a certain equilibrium among the trade balances of the firms protected by them, as a condition for the equilibrium of the mutual flows that determine the existence of intra-industry trade.

These features are clearly visible both in the arrangements established for the motor industry between Argentina and Brazil and in the Mexican free zones subject to maquila arrangements. In this latter case, they have resulted in special trade, industrial and fiscal policies for the officially extraterritorial areas in which export processing zones are installed.

These mechanisms have shown themselves to be suitable for promoting both intra-hemispheric and intra-regional trade, with flows which, because of their high income elasticity of demand and the intra-industry nature of their production and trade, may be sustainable in the long term.

A central issue in future open regionalism strategies will be the identification of the most suitable means of attracting FDI without giving rise among the member countries of a given integration scheme to struggles for such capital which may end up harming the interests of all of them. The information collected on the motor industry suggests that the countries concerned managed to attract and retain transnational productive capital not just through economic liberalization but also through special arrangements agreed between the enterprises involved and the members of a given integration scheme.

(Original: Spanish).

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IV Inflation, adjustment and stability

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