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THE INTERNATIONAL ECONOMIC CRISIS AND LATIN AMERICA'S CAPACITY TO RESPOND TO IT

A preliminary version of this document was presented at the Meeting of Latin American Personalities held at Bogotá, Colombia, on 19 May 1983.

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/INTRODUCTION

INTRODUCTION

In 1982 Latin America experienced its most profound economic crisis since the Great Depression of the 1930s. Caused by a complex group of external and internal factors, the crisis made itself felt in nearly all the main macroeconomic variables and affected the vast majority of the countries of the region to a greater or lesser extent. At the end of December 1982, in his preliminary balance-sheet of the Latin American economy for that year, the Executive Secretary of ECLA gave the main background and appraisals of the magnitude and impact of the crisis, on the basis of the data available at that time.*/

In that preliminary balance-sheet it was recognized that to overcome the crisis it was necessary for the Latin American countries to move towards a new style of development and a new system of international economic relations in keeping with the profound changes in the world scenario. It was also pointed out that the possibility of finding a way out of the current crisis and making progress towards the changes which would be required in the future lay in the response which the countries of the region might make to the current problems in the short and medium term. In other words, emphasis was laid on the fact that the possibility of finding new forms of development and insertion into the external economy for the region would depend fundamentally on the measures adopted now for coping with the crisis, but that in designing those measures it should always be borne in mind that a basic and lasting solution to the problems raised by the current economic situation would require structural changes in the long term. Thus, the emergency measures adopted should not stand in the way of but should rather favour the initiation of those changes.

The Executive Secretary of ECLA ended his remarks as follows:

"I should like to conclude this address by repeating that CEPAL will shoulder its full share of responsibility as regards contributing to the study and solution of the serious problems affecting the region today. To this end -and in pursuit of a practice which has borne valuable fruit at other crucial junctures in the past- I wish to report that the CEPAL Secretariat has decided to convene -at the earliest possible date compatible with due preparation- a select group of Latin American personalities with a view to learning their views and proposals on the subject under discussion, which will have an enlightening influence on our institution's activities and which may be useful in assisting all of us to discover the solutions for which in the present circumstances our countries are calling".

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*/ See Notas sobre la Economía y el Desarrollo de América Latina, No. 373, January 1983, prepared by the ECLA Information Service.

/Accordingly, the

Accordingly, the Executive Secretary convened a group of Latin American personalities to study, in a strictly personal capacity and without compromising the position of their respective governments or institutions, the impact of the international economic crisis on Latin America and also possible solutions to it. The present document has been prepared for the purpose of helping those personalities in their deliberations by providing them with background material and data on which to base their decisions.

For the reasons noted above, this document concentrates on the conjunctural aspects of the crisis and on the measures which should be adopted to deal with it in the short and medium term, bearing in mind the transformations which Latin America must consider making in the future and the implications which they must have for the action undertaken here and now. It is necessary to bear constantly in mind that the impact of the present crisis on Latin American economies and societies has come in the wake of serious and deep-rooted problems which arose further back in the past and are still unsolved in spite of the by no means negligible progress made by the region since the war. The Secretariat has studied these problems on other occasions, especially during the nineteenth session of the Commission held at Montevideo in April 1981. The report submitted at that time by the Executive Secretary of ECLA not only drew attention to the growth and transformation experienced by the Latin American economies and to the greater ability which the region has been acquiring over the past 30 years to cope with problems of external origin, but also analysed the problems raised by social inequity, food security, the energy transition, the growing restrictions in the field of international trade and the contradictions implicit in the new forms of external financing.*/

The circumstances which led to the convening of the meeting of Latin American personalities mentioned above, unlike those surrounding other occasions of a similar nature, make it advisable to concentrate on the problems arising out of the present economic situation and on the measures required for coping with that situation in the short term. This analysis should be viewed against the background of the discussions relating to the longer term.

*/ See the statement made by the Executive Secretary of ECLA at the nineteenth session of the Commission, issued under the title "Development and equity: The challenge of the 1980s", in CEPAL Review, No. 15, December 1981.

Chapter I

THE GREAT LATIN AMERICAN CRISIS

Latin America is now in the throes of its most severe economic crisis since the Great Depression of the 1930s. This crisis, which has been caused by a complex series of factors in which the leading role has been played, as we shall see, by those of external origin, but in which the inadequacies and excesses of national economic policies have also had a crucial influence, has had a decisive, although unequal, effect on all the economies of the region and, in the great majority of them, is showing no signs of abating.

From the long historical perspective of Latin American development over the past 40 years, it is precisely the large number and varied kinds of economies in the region which are affected by the crisis which constitute the main and least expected characteristics of the crisis. Another of its peculiar characteristics, which is certainly no less disturbing or unusual, has been the degree of deterioration which the majority of the main economic indicators have demonstrated simultaneously and which they continue to demonstrate now.

Thus, as from 1981 the growth rate of economic activity began to fall, and in 1982 it declined even in absolute terms. This marked loss of dynamism was accompanied by a sharp rise in the rates of open unemployment and in the various kinds of underemployment. At the same time, inflationary processes were becoming more generalized, reaching an intensity and persistency scarcely imaginable only a few years previously. These unfavourable changes on the internal scene were closely linked with other equally severe changes in the external sector, the most obvious effects of which have been the severe balance-of-payments crises, the frequent and in some cases enormous rises in exchange rates, the drain on international reserves and, more especially, the crushing and unbearable burden which the servicing of the external debt has come to represent.

The deep-rootedness and unusual scope of the present crisis are even more apparent if they are viewed within the framework of Latin America's evolution since the war. From this angle, the recent economic contraction appears as a severe setback in the long period of growth and transformation begun by the majority of the Latin American countries following the Second World War and characterized, in general, by an appreciable degree of economic dynamism. Thus, between 1950 and 1980 the region's gross domestic product grew at an average annual rate of 5.5%, which meant that at the end of that period the volume of global economic activity was four times as high as that recorded 30 years previously. Even more intense growth was shown by industrial production, which increased over six-fold in that period, and by capital formation, thanks to which the investment coefficient grew gradually but steadily from the mid-1960s onwards.

However, in addition to marking the end of the long period of expansion following the war, the variety of severe economic problems which began to appear throughout the region from 1981 onwards also marked a crisis in the development strategy followed to varying degrees by many Latin American countries during the preceding decade, especially after the first round of oil price rises.

/As will

As will be seen in greater detail below, this strategy took advantage on the special conditions created on the world economic scene after the first petroleum crisis, particularly in the financial field, to procure considerable and rapidly growing external savings. Thanks to the inflow of these resources and also to the intense and persistent increase in the volume of its exports during the period 1976-1980, the region was able to secure a steady and significant increase in the volume of its imports. This in turn made it possible to maintain a rate of growth during this period which, although lower than the exceptionally high rate achieved during the first half of the 1970s, was well above that recorded by the industrialized countries. In fact, the easy access to foreign credit not only made it possible for the majority of the Latin American countries to weather with relative ease the effects of the international recession of 1974-1975 but also allowed its global economic growth to be largely disassociated from that of the industrialized countries.

However, the price paid for this situation, which was well-nigh unique in the recent economic history of the region, and the basic factor on which it depended was the extraordinary rise in the external debt and also the very rapid growth of the deficit on current account of the majority of the Latin American countries. Thus, in practice, the possibility of maintaining a relatively high growth rate came to be more and more closely and directly related to the possibility of attracting increasingly large amounts of external resources and also the ability to keep up a rapid expansion of the volume of exports.

These were the circumstances in which Latin America began to receive the full impact of the prolonged and intense recession which became still more acute in the industrialized countries in 1980, and in which Latin America had to adapt to the profound changes occurring from that time onwards in the international capital markets. While the recession helped to slow down the growth of exports and contributed to the dramatic deterioration of the region's terms of trade, the changes in the financial markets resulted in a very marked rise in the real rates of interest and in an equally sharp drop in the net inflow of external resources.

A fact which has already been noted and will be considered in greater detail below is that that combination of negative changes in the region's situation was the main, although by no means the only, cause of the crisis which the majority of the Latin American countries have been experiencing since 1981. Moreover, as will also be seen below, by undermining one of the chief supports of the development strategy based on external financing, this began to show up the intrinsic weakness of that strategy, and the need to introduce profound changes in the predominant development pattern of the region became evident.

/A. The

A. The symptoms of the crisis

1. The decline in economic activity

The radical change which occurred in the economic growth rate can be clearly seen by studying the figures for recent years shown in figure 1, which gives the annual and five-year average rates of growth of the gross domestic product of Latin America during the period 1945-1982. Thus after achieving a fairly high average growth rate of over 6% in the biennium 1979-1980, economic activity scarcely grew at all in 1981, so that the per capita product of Latin America fell slightly (something which had happened only once during the entire postwar period -in 1959). The deterioration continued to get worse in 1982 when, as already noted, economic activity not only failed to increase but actually experienced a contraction in absolute terms.

This drop in the global product (the first in Latin America in over 40 years) was, however, very widespread. Thus, according to the preliminary data shown in table 1, the gross domestic product shrank in 11 of the 19 countries considered, remained virtually stagnant in another 3 and experienced only a slight rise in 4. Even in the latter countries, however, the rate of economic growth was lower than that of the population. Finally, in 1982 a most surprising fact was recorded: with the sole exception of Panama, where economic activity rose by 4%, and Cuba, where it is estimated that the global social product increased by around 2.5%, the per capita product fell in every country in the region (see table 2).

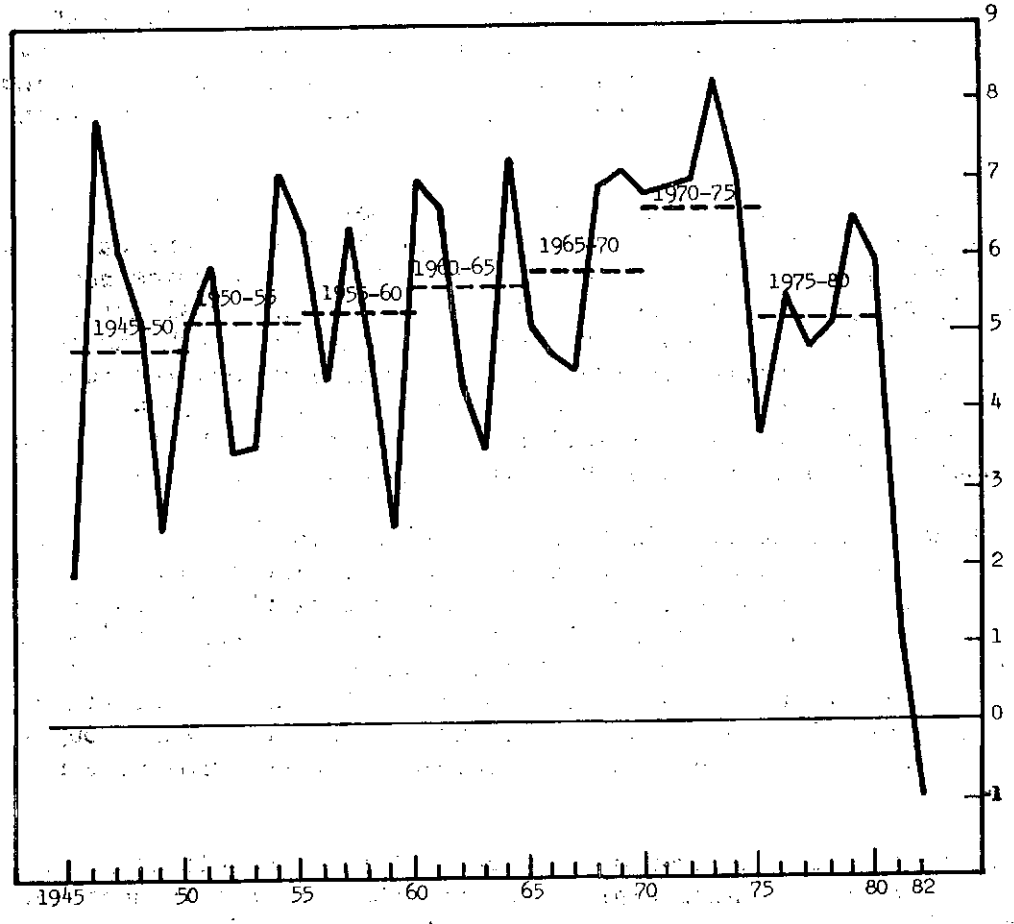
The magnitude of the decline in economic activity and the fundamental influence exerted in this respect by socio-political conflicts in some countries and the management of the economy in others become evident when we observe that in 1982 the per capita products of El Salvador and Nicaragua were similar to those obtained in those countries 20 years previously; that of Chile was lower in 1982 than in 1966; that of Argentina was lower than in 1969, that of Bolivia was barely higher in 1982 than in 1971, while those of Costa Rica and Peru were roughly the same as those achieved in 1973 and those of Guatemala and Honduras were no higher in 1982 than in 1977.

Two other particularly unfavourable aspects of the economic stagnation were the setbacks suffered by the industrial sector and the increase in unemployment and underemployment. Thus, the production of manufacturing activities, whose growth and diversification are fundamental for increasing the capacity of the Latin American economies for development and change, had already suffered a decline in 1981, contracted again in 1982 and will probably decrease again in many countries in 1983. This shrinkage of the industrial sector, which is in marked contrast with the leading role played by it during the long period between the Great Depression and the current crisis, was especially severe in those countries of the region which had most abruptly tried to open up their economies through stabilization programmes and programmes for managing exchange, tariff and interest-rate policies; these measures helped to make many manufacturing activities much less profitable and caused industrial production to fall in 1982 to levels already reached 10 or 15 years earlier.

/Figure 1

Figure 1

LATIN AMERICA: ANNUAL GROWTH RATES OF THE GROSS DOMESTIC PRODUCT



Source: ECLA, on the basis of official data.

/Table 1

Table 1

LATIN AMERICA: EVOLUTION OF THE GLOBAL GROSS DOMESTIC PRODUCT

(Annual growth rates)

Country	1970-1974	1975-1978	1979	1980	1981	1982a/
Argentina	4.1	0.4	7.1	1.1	-5.9	-5.7
Bolivia	5.6	5.1	1.8	1.2	-1.1	-9.2
Brazil	11.5	6.3	6.4	8.0	-1.9	1.1
Colombia	6.6	4.9	5.4	4.1	2.5	1.2
Costa Rica	7.1	5.7	4.9	0.6	-3.6	-5.9
Chile	0.9	1.7	8.3	7.8	5.7	-14.1
Ecuador	11.4	7.0	5.1	4.8	4.3	2.0
El Salvador	4.9	5.4	-1.5	-9.6	-9.5	-5.4
Guatemala	6.4	5.5	4.7	3.7	0.9	-3.5
Haiti	4.7	3.3	5.1	5.8	0.3	0.3
Honduras	4.3	5.8	6.8	2.8	0.1	-1.0
Mexico	6.8	5.3	9.2	8.3	8.0	-0.2
Nicaragua	5.4	1.5	-25.5	10.0	8.5	-2.0
Panama	5.8	3.5	4.5	13.1	3.8	4.0
Paraguay	6.4	9.2	10.7	11.4	8.5	-2.0
Peru	4.8	1.5	4.1	3.8	3.5	0.2
Dominican Republic	10.1	4.8	4.6	5.8	3.6	1.5
Uruguay	0.6	4.1	6.2	5.8	-1.3	-10.0
Venezuela	5.4	6.1	0.9	-1.5	1.0	0.4
Latin America (19 countries)	7.2	4.8	6.5	6.0	1.5	-0.9

Source: ECLA, on the basis of official statistics.

a/ Provisional estimates.

/Table 2

Table 2

LATIN AMERICA: EVOLUTION OF THE PER CAPITA GROSS DOMESTIC PRODUCT a/

Country	Dollars at 1970 prices				Annual growth rates			
	1970	1975	1980	1982 b/	1979	1980	1981	1982 b/
Argentina	1 256	1 318	1 352	1 161	5.4	-0.2	-7.4	-7.2
Bolivia	317	372	384	327	-0.8	-2.0	-3.7	-11.6
Brazil	525	779	964	914	4.0	5.6	-4.1	-1.2
Colombia	598	707	824	818	3.2	1.9	0.3	-1.0
Costa Rica	740	875	972	835	1.9	-2.3	-6.2	-8.4
Chile	967	794	1 047	919	6.5	6.0	3.9	-15.5
Ecuador	420	622	730	729	1.9	1.6	1.1	-1.1
El Salvador	422	476	428	346	-4.3	-12.2	-12.1	-8.1
Guatemala	439	494	560	515	1.6	0.7	-2.1	-6.3
Haiti	123	135	147	142	2.6	3.3	-2.2	-2.2
Honduras	313	300	357	330	3.1	-0.7	-3.3	-4.3
Mexico	978	1 142	1 365	1 395	6.2	5.4	5.1	-2.8
Nicaragua	431	480	345	344	-27.9	6.4	5.0	-5.2
Panama	908	996	1 155	1 191	1.6	9.1	1.4	1.7
Paraguay	383	452	633	633	7.1	7.9	5.2	-4.1
Peru	646	707	677	664	1.3	1.0	0.7	-2.6
Dominican Republic	398	532	600	602	-0.9	6.7	1.2	-0.8
Uruguay	1 077	1 155	1 397	1 225	5.5	5.1	3.1	-10.6
Venezuela	1 205	1 278	1 274	1 209	-2.5	-4.8	-2.3	-2.9
Latin America (19 countries)	720	870	1 009	967	3.9	3.5	-1.0	-3.3

Source: ECLA, on the basis of official statistics.

a/ At market prices.
b/ Provisional estimates.

/2. The

2. The deterioration in employment

Owing to the global stagnation and in particular to the drop in industrial production and the even more violent decline suffered in recent years by the construction sector, the rate of open unemployment showed a tendency to rise in 1982 in the majority of the urban centres for which information is available, reaching dramatic proportions in some cities, as may be seen from table 3. Moreover, in certain countries of the region the sharp rise in open unemployment was accompanied by an appreciable increase in the number of people engaged in the production of services of doubtful social significance or employed in government programmes which, although intended to relieve unemployment, are characterized by definite underutilization of the productive potential of the workers hired and pay them much less than they obtained in their former occupations.

Of course the rise in the rates of unemployment, the proliferation of various types of underemployment and, above all, the persistence of both has meant a very large economic sacrifice in terms of the production and income which could have been obtained but which in the end were not achieved, as well as in terms of the high and unfair social cost which has been inflicted and continues to be inflicted on the unemployed and their families. Moreover, in many cases the underutilization of labour has been caused by the reduction, bankruptcy or final closure of large production firms, so that it has involved breaking up the teams of workers -frequently very valuable teams- which were employed in them and can certainly not be easily put together again. It is because of this, and also because the scarcity of job opportunities for professional and technical personnel and skilled labourers tends to cause them to emigrate, that the present employment crisis, as well as representing a loss of current production, places severe restrictions on the outlook for the expansion and diversification of economic activities in the future.

3. The acceleration of the inflationary processes

Despite the weakening in the economic growth rate and the increase in unemployment and underemployment, the third distinctive feature of the crisis has been the spread and strengthening of inflation. As may be seen from table 4, the average weighted rate of growth of consumer prices in the region as a whole was 84% in 1982: a figure far surpassing those recorded in any other year. Thus, in 1982, price levels quadrupled in Bolivia, more than trebled in Argentina, nearly doubled in Brazil and Mexico, and rose by over 80% in Costa Rica and by over 70% in Peru. Consequently, in 1982, seven out of every ten Latin Americans had to cope with exceptionally virulent inflationary processes. Moreover, in the second half of that year, the rate of the price increases in Chile and Uruguay, which had shown a downward trend, suddenly reversed itself, as may be seen from figure 2. In addition, both the considerable price rises in the first months of 1983 in many countries and the inflationary effects generated by the exchange rate decisions recently adopted in Brazil, Ecuador and Venezuela make it likely that the average rate of price increases in Latin America will either remain the same in 1983 or even rise.*/

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*/ In the first three months of 1983 alone, consumer prices rose by 46% in Argentina, by 30% in Brazil, by 27% in Peru, by 24% in Bolivia and by close to 23% in Mexico. In all these countries, with the exception of Bolivia, the price increases were much higher than those recorded in the corresponding period in 1982.

/Table 3

Table 3

LATIN AMERICA: EVOLUTION OF URBAN UNEMPLOYMENT

(Average annual rates)

	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982
Argentina a/	5.4	3.3	2.6	4.5	2.8	2.8	2.0	2.3	4.5	4.7
Brazil b/	...	...	...	...	...	6.8	6.4	6.2	7.9	6.3
Colombia c/	...	12.7	10.6	10.2	9.3	8.8	8.9	9.7	8.2	9.3
Costa Rica d/	...	...	...	5.4	5.1	5.8	4.9	6.0	9.1	9.8
Chile e/	4.8	8.3	15.0	17.1	13.9	13.8	13.4	11.7	9.0	19.9
Mexico f/	7.5	7.2	7.2	6.8	8.0	6.9	5.7	4.5	4.2	4.1
Paraguay g/	...	...	...	...	5.4	4.1	5.9	3.9	2.2	...
Peru h/	5.0	4.1	7.5	6.9	8.7	8.0	6.5	7.1	6.8	6.4
Uruguay i/	8.9	8.1	...	12.8	11.8	10.1	8.3	7.4	6.6	11.9
Venezuela j/	...	7.6	8.3	6.8	5.5	5.1	5.8	6.6	6.8	8.2

Source: ECLA and PREALC, on the basis of official statistics.

a/ Federal capital and Greater Buenos Aires. Average from April to October.
b/ Metropolitan areas of Rio de Janeiro, São Paulo, Belo Horizonte, Porto Alegre, Salvador and Recife. Twelve-month average. 1980: average for June to December.
c/ Bogotá, Barranquilla, Medellín and Cali. Average for March, June, September and December. 1974: June.
d/ Urban. Average for March, June and November. 1976: average for July and November.
e/ Greater Santiago. Average for four quarters.
f/ Metropolitan areas of Mexico City, Guadalajara and Monterrey. Average for four quarters.
g/ Asunción, Fernando de la Mora, Lambaré and urban areas of Luque and San Lorenzo. 1981: first semester.
h/ Metropolitan Lima. Averages calculated according to the data available for each year.
i/ Montevideo. Average for two semesters. 1973: first semester. 1974: second semester.
j/ Urban. Average for two semesters. 1982: first semester.

/Table 4

Table 4

EVOLUTION OF CONSUMER PRICES

(Variations from December to December)

Country	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982
Latin America a/	12.2	13.5	20.9	36.3	40.0	57.6	61.5	40.4	38.6	53.8	56.0	57.9	84.0
Countries with traditionally high inflation	14.4	15.6	24.1	41.5	44.9	69.3	74.8	48.4	45.9	61.9	66.3	68.3	97.1
Argentina	21.6	39.1	64.2	43.9	40.1	334.9	347.5	150.4	169.8	139.7	87.6	131.2	209.7
Brazil b/	17.7	18.1	14.0	13.7	33.8	31.2	44.8	43.1	38.1	76.0	95.6	91.5	97.9
Colombia c/	3.5	14.1	14.0	25.0	26.9	17.9	25.9	29.3	17.8	29.8	26.5	27.5	24.0
Chile	34.9	22.1	163.4	508.1	375.9	340.7	174.3	63.5	30.3	38.9	31.2	9.5	20.7
Mexico	7.8	-0.8	5.6	21.3	20.6	11.3	27.2	20.7	16.2	20.0	29.8	28.6	98.8
Peru	5.7	7.7	4.3	13.8	19.2	24.0	44.7	32.4	73.7	66.7	59.7	72.7	72.9
Uruguay	19.3	35.6	94.7	77.5	107.2	66.8	39.9	57.3	46.0	83.1	42.8	29.3	20.5
Countries with traditionally moderate inflation	2.8	4.6	7.2	15.0	19.8	10.2	7.8	8.3	10.0	22.1	16.0	15.0	33.7
Barbados	9.2	10.1	10.4	26.0	36.6	12.3	3.9	9.9	11.3	16.8	16.1	12.3	6.8
Bolivia	3.8	3.3	23.6	34.8	39.0	6.6	5.5	10.5	13.5	45.5	23.9	25.2	296.6
Costa Rica	4.3	1.9	6.9	15.9	30.6	20.5	4.4	5.3	8.1	13.2	17.8	65.1	81.7
Ecuador	8.0	6.8	6.9	20.6	21.2	13.2	13.1	9.8	11.8	9.0	14.5	17.9	23.9
El Salvador	1.0	-0.6	5.2	7.9	21.0	15.1	5.2	14.9	14.6	14.8	18.6	11.6	13.4
Guatemala	1.0	0.3	1.1	17.5	27.5	0.8	18.9	7.4	9.1	13.7	9.1	8.7	-2.0
Guyana	2.4	1.4	7.1	15.2	11.6	5.5	9.2	9.0	20.0	19.4	8.5	29.1	14.6 d/
Haiti	-0.7	13.3	7.3	20.8	19.5	-0.1	-1.4	5.5	5.5	15.4	15.3	16.4	-1.7 e/
Honduras	1.4	1.5	6.8	5.1	13.0	7.8	5.6	7.7	5.3	22.5	11.5	9.2	9.4
Jamaica	7.5	5.2	9.3	9.6	20.6	15.7	8.3	14.1	49.4	19.8	28.6	4.8	7.0
Nicaragua	...	...	...	...	...	1.9	6.2	10.2	4.3	70.3	24.8	23.2	22.2
Panama	2.5	1.0	6.7	9.7	16.7	1.4	4.8	4.8	5.0	10.0	14.4	4.8	3.9
Paraguay	2.3	6.3	9.5	14.1	22.0	8.7	3.4	9.4	16.8	35.7	8.9	15.0	4.2
Dominican Republic	-1.3	10.6	8.0	17.2	10.5	16.5	7.0	8.5	1.8	26.2	4.2	7.4	7.7 e/
Trinidad and Tobago	3.3	5.0	8.0	24.4	18.6	13.4	12.0	41.4	8.8	19.5	16.6	11.6	10.8
Venezuela	3.4	3.0	3.5	5.1	11.6	8.0	6.9	8.1	7.1	20.5	19.6	10.8	7.9

Source: International Monetary Fund, International Financial Statistics, April 1983, and official data supplied to ECLA by the countries concerned.

a/ The totals for Latin America and the partial figures for groups of countries represent variations by countries, weighted by their respective populations in each year.

b/ Up to 1979 corresponds to the variation in the Rio de Janeiro consumer price index and from 1980 onwards to the variation in the total national CPI.

c/ Up to 1980 corresponds to the variation in the consumer price index for manual workers and from 1981 onwards to the variation in the total national CPI, which includes manual workers and employees.

d/ Variation between June 1981 and June 1982.

e/ Variation between September 1981 and September 1982.

/Figure 2

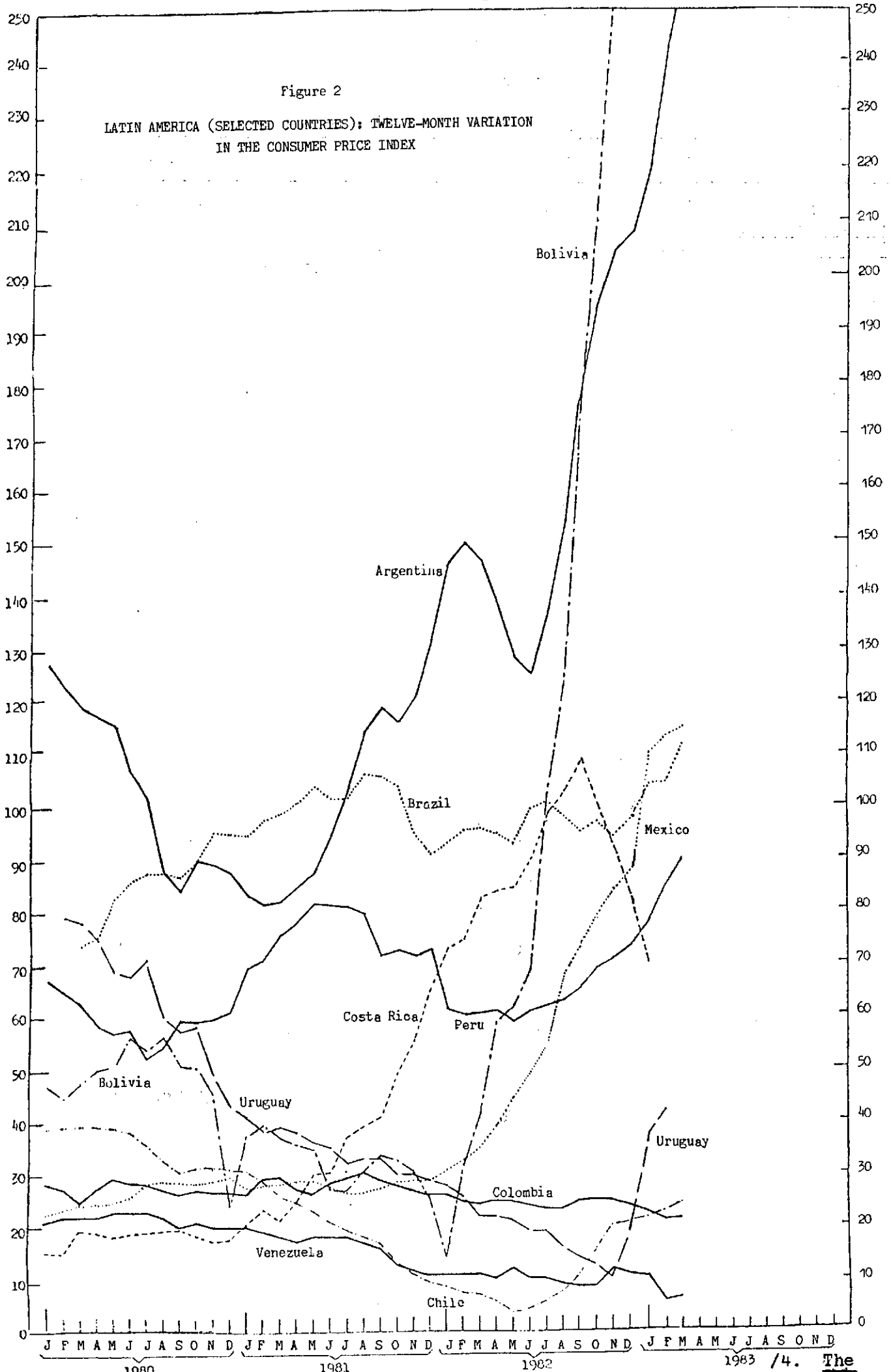
Figure 2
LATIN AMERICA (SELECTED COUNTRIES): TWELVE-MONTH VARIATION IN THE CONSUMER PRICE INDEX
Bolivia
Argentina
Brazil
Mexico
Costa Rica
Peru
Bolivia
Uruguay
Uruguay
Colombia
Venezuela
Chile
J F M A M J J A S O N D
1980
1981
1982
1983

/4. The

4. The accentuation of income distribution problems

It is also likely that income distribution problems have begun to grow worse since 1982. Thus, although the information available is not sufficiently complete or reliable, the sharp drop in real wages revealed by the statistics of some countries with up-to-date information in this field and the simultaneous increase in inflation and unemployment in other countries suggest that income distribution has became more unequal. Moreover, the initiation in a large number of the region's economies of orthodox stabilization programmes -which normally include very restrictive measures as regards wages and salaries and public expenditure, as well as providing for the liberalization of the prices of many basic consumer goods- makes it likely that the distribution problems of those economies might remain the same or worsen in the near future.

5. The crisis in the external sector

Although, as will be considered in depth below, the present severe crisis in the external sector was growing up during the past decade and has been caused by a conjuncture of factors, its immediate cause was that in recent years the countries of the region have found it virtually impossible to finance the growing deficit on current account of their balance of payments without incurring sizeable losses in their international reserves.

Thus, as may be seen in table 5, the imbalance on current transactions, after becoming very much worse in the 1974-1975 biennium, became less marked in 1976 but grew steadily and rapidly worse in the following five years, so that in 1980 the deficit on current account of the region as a whole reached a record figure of somewhat more than US$ 38.5 billion, or double the amount recorded only two years previously. However, since the net inflow of capital showed extraordinary growth during the same period, the balance of payments closed with a surplus in every year in the period, with the exception of 1980.

The evolution of the external sector changed markedly, however, in 1982 as a result of the continuation of the world economic recession, the radical change which occurred in the movement of capital, the persistence of unusually high interest rates in the international financial markets, the effects of the rapid expansion of the external debt in the preceding years and the shortcomings of the economic policies applied in certain countries of the region.

Thus, in spite of the turnaround in the trade balance, which, after showing a deficit of nearly US$ 1.9 billion in 1981, generated a surplus of US$ 8.8 billion in 1982, the balance of payments closed with an unprecedented deficit of close to US$ 14 billion. In this result a decisive effect was had first by the enormous increase in net payments of interest and profits, which amounted to over US$ 34 billion, or nearly twice the amount recorded two years previously, and above all, by the violent drop in the net inflow of capital, which fell from US$ 39 billion in 1981 to only slightly more than US$ 19 billion in 1982.

/Table 5

Table 5

LATIN AMERICA: BASIC COMPONENTS OF THE BALANCE OF PAYMENTS

(Billions of dollars)

Year	Balance of merchandise trade	Net payments of profits and interest	Balance on current account	Net inflow of capital	Balance of payments position
1970	0.7	-2.9	-3.3	4.2	1.0
1971	-0.3	-3.2	-4.6	5.1	0.5
1972	-0.04	-3.2	-4.3	7.3	3.0
1973	1.8	-4.3	-4.6	8.1	4.6
1974	-0.6	-5.1	-7.6	11.6	4.1
1975	-5.9	-5.7	-14.4	14.5	0.1
1976	-2.0	-6.9	-11.5	15.7	4.2
1977	-0.4	-8.2	-11.8	16.1	4.3
1978	-3.2	-10.4	-18.4	25.3	6.9
1979	0.1	-13.8	-19.7	25.8	6.0
1980	-1.7	-18.2	-28.4	26.2	-2.2
1981	-1.9	-27.4	-39.1	39.2	0.1
1982	8.8	-34.4	-33.0	19.2	-13.8

/Of course

Of course this dramatic drop in the inflow of the external resources also caused a considerable reduction in the growth rate of the external debt, which, after having expanded at the exceptionally high rate of nearly 25% per year between 1975 and 1980, rose by only somewhat more than 7% in 1982 (see table 6).

In spite of this, the drop in the value of exports, the dramatic increase in interest payments due to the rapid accumulation of the debt in preceding years and the high rates of interest prevailing in the international markets, and the equally substantial increase in payments of principal caused by the previous growth of the debt and the fact that its average repayment period was shorter were responsible for a dramatic rise in the debt-servicing coefficient.

In these circumstances, the sudden drop in the net flow of capital into the region in 1982 meant that a growing number of Latin American countries found it increasingly difficult to make regular and timely payments on their external debt and had to engage in complicated negotiations to secure the postponement and rescheduling of their amortization payments.

The radical deterioration in the external sector also had a very marked impact on economic policy and on the evolution of productive activity and price levels. Thus, in an attempt to stem the loss of international reserves, many countries of the region devalued their currency sharply, which contributed to a marked acceleration in the rate of their inflation. The critical balance-of-payments situation also forced many countries to adopt restrictive measures in the monetary and fiscal domain with a view to reducing the growth of domestic demand and hence of imports. However, as was to be expected, although these policies brought about a reduction in the value of external purchases, they also affected the level of domestic activity and employment.

B. The causes of the crisis

As already noted, the profound crisis in which Latin America is now sunk is due to a combination of causes. Thus, in addition to factors of a political and social nature -some of which have been of decisive importance- there have been others of an economic nature related either to structural and institutional changes which have been slow to arise and develop or else to sudden fluctuations of a temporary nature. From another angle, the origin and development of the crisis may also be attributed to exogenous factors relating mainly to the evolution of the international economy and to other factors, this time of an endogenous nature, linked in some cases to the economic policies applied and in others to bitter and prolonged socio-political conflicts.

Naturally it is not easy to determine how much influence these various factors have had on the emergence and evolution of the crisis. Moreover, the impact of each of them has of course been different in the different national experiences. However, the very widespread nature of the economic recession in the region and the fact that it coincides in time with the period in which recession and uncertainty have been the distinctive features of the evolution of the world economy suggest that factors of an external nature have been primarily responsible for the origin and duration of the crisis.

/Table 6

Table 6

LATIN AMERICA: GROSS EXTERNAL DEBT DISBURSED a/

(End-of-year balance, in millions of dollars)

Country	1975	1977	1979	1980	1981	1982 b/
Latin America	67 247	97 451	166 681	204 242	251 998	270 200
Petroleum-exporting countries	27 286	47 716	71 801	92 496	121 721	127 700
Bolivia	872	1 663	2 585	2 442	2 651	2 910
Ecuador	583	2 153	3 751	4 798	6 823	7 700
Mexico	17 265	26 503	37 746	50 216	73 737	78 000
Peru	4 066	6 260	7 116	7 901	8 502	10 100
Trinidad and Tobago	172	275	525	645	860	970
Venezuela	4 328	10 812	23 078	26 494	28 948	28 100
Non-petroleum-exporting countries	39 961	49 735	91 877	111 746	130 277	142 420
Argentina	6 026	8 210	18 299	24 543	30 794	32 100
Brazil	20 785	32 258	48 991	57 262	63 067	71 000
Colombia	3 572	3 092	5 935	7 310	8 229	9 600
Costa Rica	663	1 030	1 690	2 124	2 577	2 600
Chile	4 459	4 899	7 491	9 544	12 447	13 600
El Salvador	391	539	798	846	1 010	1 200
Guatemala	314	603	983	1 120	1 159	1 350
Guyana	206	429	527	565	664	800
Haiti	79	158	226	269	321	470
Honduras	431	726	1 130	1 303	1 426	1 650
Jamaica	665	1 220	1 320	1 388	1 558	...
Nicaragua	735	1 300	1 453	1 660	2 473	2 400
Paraguay	238	329	727	919	1 152	1 350
Dominican Republic	506	862	1 170	1 548	1 780	2 100
Suriname	20	17	110	34	40	...
Uruguay	811	973	1 027	1 311	1 880	2 200

Source: ECLA, on the basis of the following publications: World Bank, World Debt Tables. External Public Debt of Developing Countries and Territories, December 1981, provisional figures; and Economic Memorandum on Suriname, Report No. 2851, 30 May 1980; IDB, External Public Debt of the Latin American Countries, July 1981; BIS, The Maturity Distribution of International Bank Lending, July 1978, 1979, 1980, 1981 and 1982; IMF, International Financial Statistics, Vol. XXXIV, August 1981; OECD, Development Co-operation, 1977 Review, 1978 Review and Geographical Distribution of Financial Flows to Developing Countries, Paris, 1980.

a/ In addition to the officially guaranteed public and private external debt, includes the non-guaranteed long- and short-term debt with financial institutions reporting to the Bank for International Settlements and credits from the International Monetary Fund. Does not include the guaranteed and non-guaranteed debt with other commercial banks or suppliers' credits not officially guaranteed.

b/ Provisional ECLA estimates, based on the estimated movement of the relevant balance-of-payments items. For this reason, may not coincide with estimates relating to the amount of some countries' total external debt.

/1. The

1. The external causes

Three of the most important of these causes have been the world economic recession (which, as we shall see, had a very negative effect on international trade and on the terms of trade of Latin America), the unprecedented levels reached by real interest rates in the international financial markets (to a large extent attributable to the nature of the stabilization policies applied in some of the industrialized countries), and the sudden decline in the net flow of capital to the region in 1982 (which, as has already been pointed out, was the factor immediately responsible for setting off the balance-of-payments and external indebtedness crisis which the region is now experiencing).

a) The international recession

As is already well known, the early years of the past decade marked the culmination of the long phase of expansion of the central economies which began early in the 1950s and in which economic activity and international trade grew at an even faster and entirely unprecedented rate. In the middle of the past decade, however, the structural changes which had been taking shape within some of the leading industrialized countries, even prior to the first big rise in the international price of fuels, and which tended to slow down their growth, together with the effects of the sudden rise in the cost of hydrocarbons, caused the most severe contraction in the central economies ever experienced by them in the period since the war.

Although economic activity in the industrialized countries began to expand again in 1976, that expansion was by no means as intensive as it had been throughout the period referred to above. Moreover, the recovery, in addition to being relatively weak, was characterized by three other negative features -the low level of fixed investment and the simultaneous and somewhat surprising persistence of rates of unemployment and inflation which were much higher than those which had prevailed up to 1973.

It was largely due to these circumstances that the effects on the industrialized economies of the second series of rises in the price of petroleum were much more severe than those of the previous petroleum crisis, and the way in which economic policy responded was also very different.

Thus, as may be seen from table 7, the recession which began in 1980, although not so far-reaching as that of the recession of 1974-1975 in terms of its initial effects on the level of economic activity of the industrialized countries, was much more prolonged. Moreover, since the proportion of the labour force out of work in the industrialized countries at the beginning of the current recession was much higher than the corresponding proportion at the beginning of the preceding recession, the stagnation of economic activity in the present recession was accompanied by the highest rates of unemployment recorded in the industrialized countries since the Great Depression of the 1930s.

As in other recessions, the stagnation of the economic activity of the industrialized countries had unfavourable effects on their demand for imports and, ultimately, on the rate of growth of international trade. This time, however, the adverse consequences of the recession were further aggravated by the fact that

/Table 7

Table 7

OECD: GROSS DOMESTIC PRODUCT, INFLATION AND UNEMPLOYMENT

(Annual growth rates)

	1962-73	1973	1974	1975	1976	1977-79	1980	1981	1982a/
Gross domestic product	5.0	6.1	0.7	-0.5	5.3	3.6	1.3	1.2	-0.5
Consumer prices	3.7	7.8	13.4	11.3	8.6	8.9	12.9	10.6	8.0
Unemployment b/	3.0c/	3.2	3.5	5.2	5.3	5.2	5.8	6.8	8.5

Source: OECD, Economic Outlook (various issues).

a/ Provisional figures.
b/ Percentage.
c/ Refers to the period 1966-1972.

/the many

the many central economies once again began to make use of protectionist practices in their trade policies, and these practices became more frequent and severe as unemployment increased and the recession continued. In these circumstances, the volume of international trade, whose rapid expansion had played a fundamental role in the growth of the world economy during the postwar period, grew only very slightly in 1980, stagnated almost completely in 1981, and fell by 2% in 1982. At the same time, the international prices of the majority of commodities fell sharply, causing a serious deterioration in the terms of trade of the non-oil-exporting developing countries.

In spite of this unfavourable evolution of international trade, between 1976 amd 1981 the countries of Latin America still managed to increase the volume of their exports at an exceptionally high average rate of close to 8% and were therefore able to stave off the unfavourable effect of the deterioration in the terms of trade on the purchasing power of their exports up until 1981. In 1982, however, when the recession in the industrialized countries continued into its third consecutive year and the volume of world trade fell in absolute terms, the real expansion of Latin American exports came to an absolute standstill. At the same time, the terms of trade of the non-oil-exporting countries deteriorated markedly for the fifth consecutive year, with the result that their average value in the three-year period 1980-1982 was less than that recorded during the years 1931-1933, the most critical period of the Great Depression.

b) The high cost of external credit

Equally serious for Latin America have been the consequences of the extraordinarily high levels to which interest rates have risen in the international financial markets in recent years.

Because of the high priority accorded by the majority of the industrialized countries to the reduction of inflation, and in particular because of the great importance attached by some of them in accomplishing this task, to the control of the money supply, interest rates began to rise markedly from 1978 onwards in the main international financial centres. Indeed, in real terms they rose during 1982 and 1983 to the highest levels recorded since the Great Depression. This situation was in sharp contrast with that which prevailed in the crisis of the mid-1970s, during which, as may be seen in figure 3, the real interest rate remained negative throughout.

The unusually high interest rates also helped to unleash and aggravate the crisis in Latin America in the following two main ways. First, by checking the recovery of the industrialized economies, they helped to reduce the demand in them for exports from Latin America. Secondly, by increasing the external debt servicing costs, high interest rates were partly responsible for the enormous expansion in the deficit on current account and made it necessary to effect a much larger real transfer of resources to the exterior.*/

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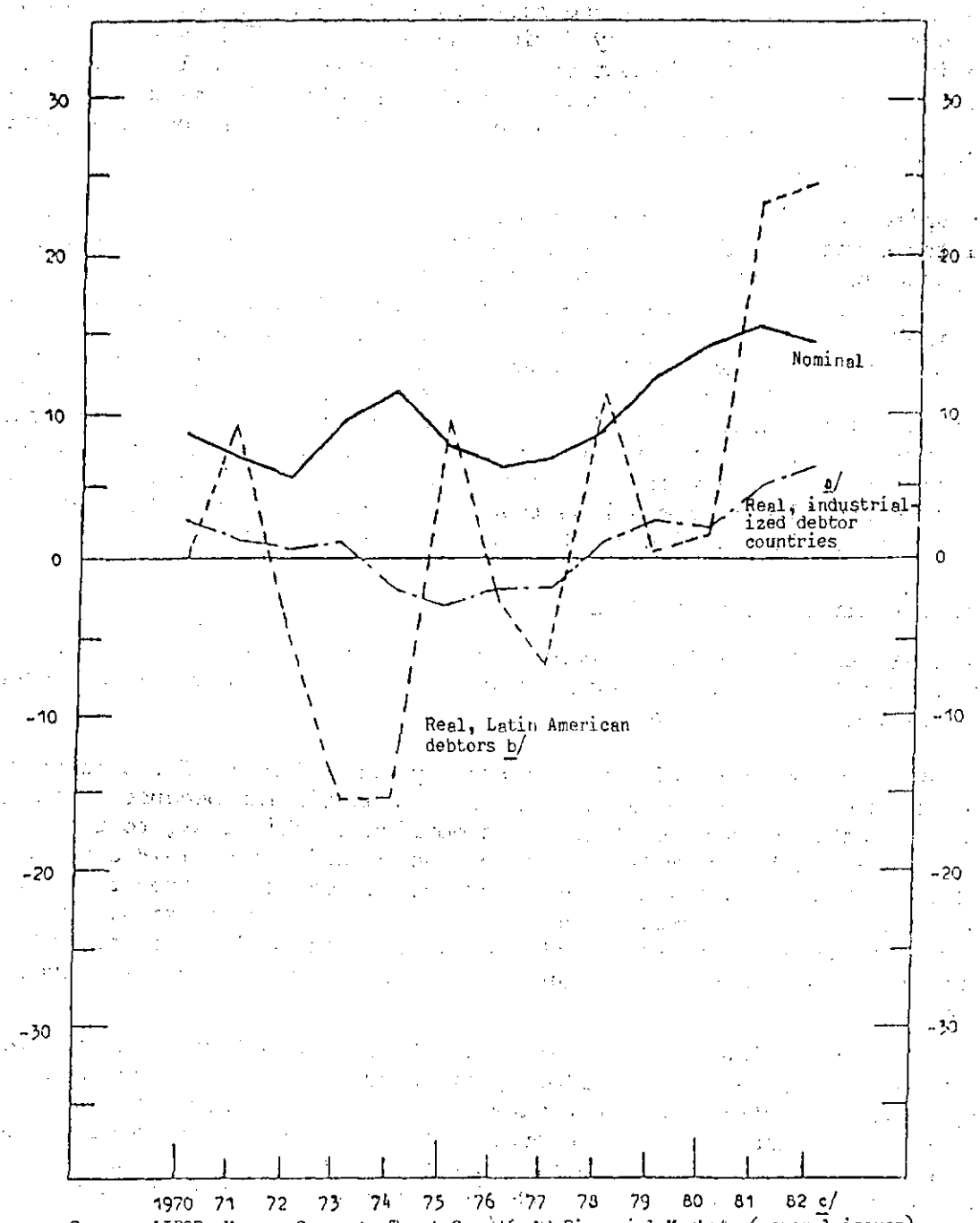
*/ This problem was accentuated by the fact that during the 1970s an increasingly large share of Latin America's external debt was contracted at floating interest rates. As a result, the rise in interest rates not only affected new loans but was also passed on to a large proportion of the debt contracted previously.

/Figure 3

Figure 3

EVOLUTION OF THE LONDON INTER-BANK OFFERED RATE (LIBOR), NOMINAL AND REAL



Source: LIBOR: Morgan Guaranty Trust Co., World Financial Markets (several issues).
Consumer prices: IMF, International Financial Statistics Yearbook, 1981 and International Financial Yearbook, December 1982.
Unit value of exports: ECLA, on the basis of official data.

a/ Nominal LIBOR over six months converted by deflation using consumer prices in industrialized countries.

b/ Nominal LIBOR over six months converted by deflation using the unit value of the exports of the Latin American non-petroleum-exporting countries.

/It is

It is worth recalling in this respect that from the point of view of the debtor countries, the magnitude of the real sacrifice involved in the payment of interest on the external debt depends not only on the nominal interest rate but also on the relation between that the rate and the variations in export prices. In other words, the burden of real resources which the debtor country must transfer to the exterior in order to service the debt will rise both in proportion as the nominal interest rate increases and in proportion as the prices of the country's exports fall.

This was precisely the situation which Latin America had to face in the period 1981-1982. As already noted, during this period not only did interest rates on international financial markets reach exceptionally high levels but there was also a sharp drop in the unit value of Latin American exports. The results of this combination of events were dramatic: as may be seen from figure 3, the real interest rate which Latin America had to pay was around 24%, or four times the rates paid in those years by debtors among the central countries, even though these latter rates were the highest for the last half-century.

In these circumstances, it was not surprising that in 1982 a growing number of countries in the region experienced increasing balance-of-payments difficulties, since the current account equilibrium was simultaneously threatened by the deterioration in the terms of trade and the stagnation in the volume of exports on the one hand, and the considerable increase in interest payments on the other.

c) The decline in the net inflow of capital

Nevertheless, the factor which precipitated the balance-of-payments crisis of 1982 was the sudden decline in the net inflow of capital, which made it necessary to finance a considerable amount of the current account imbalance with international reserves and forced many economies to initiate a process of adjustment to the recession. The impact of this drop in the inflow of external resources was especially severe because it occurred after a long period in which the net inflow of capital had grown with remarkable intensity and during which not only the evolution of the external sector but also the general functioning of many Latin American economies had become very much dependent on a steady increase in financing from the exterior.

The indebtedness process, which was basically related to the generation of the big financial surpluses which the oil-exporting countries began to accumulate as from 1984, to the central role which the private international banks began to play in the recycling of those surpluses, to the channelling of a considerable share of them to the semi-industrialized economies, and to the development strategies adopted by many Latin American countries which were heavily dependent on external indebtedness, was characterized by three main features which were closely interrelated.

The first and most obvious of these was the staggering growth of the external debt to which it gave rise. As already noted, between 1975 and 1981 the gross external debt of Latin America quadrupled from US$ 67 billion to US$ 270 billion. During this period, its average growth rate was close to 24%: much higher than the also very high growth rate of 18% registered by the value of Latin American exports and than the rate at which the capital of the international private banks increased.

/The second

The second salient feature was the dramatic change which occurred in the sources of indebtedness, with private sources coming to play a leading role. Thus, the participation of private banking in the external debt of Latin America, which was very moderate at the end of the 1960s, rose extremely rapidly during the past decade, coming close to 80% in recent years. This development was to a large extent a reflection of similar changes at the world level, where, by the beginning of the past decade, liquid resources mobilized by private banking began to overshadow those from public international financial institutions.*/

This shift in the structure of external indebtedness was, for its part, the main cause of the third distinctive feature of the process of indebtedness over the past ten years, i.e., the notable deterioration in the terms of the credits obtained. Since the majority of the new loans were granted by private banks, while the national and international public financing entities increased their transactions in Latin America at a much slower rate, the rates of interest and the commissions which the countries of the region had to pay were much higher than in the past, and the average repayment periods were markedly reduced. Because of this, debt servicing rose rapidly, as did the proportion of the new loans which had to be used for paying the interest and amortization relating to them.

The negative consequences and long-term impracticability of this situation did not become evident until the beginning of the 1980s, because of the low level of real interest rates which in general prevailed up to 1980 and the extremely favourable attitude shown by the private international banks with regard to expanding the financing granted to Latin America.

From 1981 onwards, and especially in 1982, however, these circumstances changed radically. As already noted, real interest rates reached unusually high levels, while the financial surpluses of the petroleum countries fell because of the weakening of international oil prices and the excessive expansion of domestic expenditure which not a few of them had permitted in previous years. This circumstance, together with the new awareness on the part of the private international banks of the balance-of-payments difficulties which many Latin American countries were beginning to show as a result of the persistent and sharp drop in commodity prices and their growing external debt servicing burden, helped to bring about an abrupt change in the financial institutions' evaluation of the advantages and risks involved in continuing to extend their credit to the region.

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*/ The decline in the relative importance of resources from the International Monetary Fund is a good illustration of this process. Thus, when that institution was founded, its resources were equivalent to 16% of the value of world trade, whereas at present they represent only about 3% of it.

/The reluctance

The reluctance of the banks became even more apparent when hostilities broke out in the Falklands and Mexico's exchange rate and payments crisis began to grow worse, and it further increased when the political unheavals in some Central American countries intensified and resulted in a more or less general decline in economic activity in the region.*/

Thus, in contrast with what happened in the 1974-1975 biennium, when the inflow of capital rose and thereby compensated somewhat for the effects of the international recession, in 1982 the reduction in the flow of loans aggravated the cyclical drop in foreign trade and further accentuated the balance-of-payments crisis.

In these circumstances, as already noted, many Latin American countries reacted by devaluating their currencies sharply, which helped to reduce the volume of imports and encourage growth of the volume of exports. Nevertheless, much of this effort was offset by the drop in international commodity prices, since in 1982 there was a marked slackening in growth or even an actual reduction in the capacity of the central countries and also of less traditional buyers, such as the petroleum-exporting countries and the socialist countries, to absorb more imports.

Thus, because of difficulties in expanding the volume of exports, deterioration in the terms of trade, the phenomenal increase in debt servicing and the pro-cyclical nature of the net movement of capital in 1982, the adjustment in the current accounts of the Latin American countries had to be made largely by reducing the volume of imports. But that in turn meant that there had to be either a marked decrease in the growth rate of production or even a decline in economic activity in absolute terms.

From a broader perspective, not only was the reduction in the flow of loans to the region in 1982 a decisive factor in the present crisis, but it also showed some of the structural limitations inherent in the kind of external financial relationship which has characterized the recent development of many economies of the region.

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*/ The abrupt decline in the credits in Eurodollars granted to Argentina, Brazil, Colombia, Chile, Ecuador, Mexico, Peru and Venezuela during the second half of 1982 is a clear illustration of the about-face in the attitude of the banks. Thus, after receiving a total of US$ 16 650 million between January and June of that year, this group of countries was only able to attract an amount slightly under US$ 7 500 million between July and December. The decline was especially severe in the case of Mexico, where the total credits received during the second half of the year were equivalent to barely 9% of those attracted in the first half of the year, and was even more serious in the case of Argentina, where the loans granted not only fell from US$ 1 550 million in the second half of 1981 to US$ 465 million between January and June 1982, but faded out completely in the second half of the latter year.

/This process

This process has involved costs and benefits both for the Latin American countries and for the central economies and the international commercial banks. The credit which the latter granted to Latin America and to other regions of the periphery did indeed greatly stimulate the growth of the central economies by expanding their exports. Thus, a recent study shows that during the 1970s the developing countries constituted the most dynamic market for the goods of the central economies, since they purchased about one-third of the increase in the exports from those economies.*/ Moreover, the new market which Latin America represents for the international banks generated a high rate of gain for the latter.

As for the Latin American countries, in spite of the fact that only some of the external credit was used for productive investment, the use of international bank credits constituted one of the conditions which allowed the region to grow at a considerably higher rate than the industrialized countries. Indeed, the margin by which the growth of Latin America exceeded that of the latter countries was significantly higher since 1972 than in preceding years.

However, the central problem consisted in the fact that in the circumstances which prevailed, this flow of credit, in spite of its short-term positive effects on the rate of expansion of economic activity in Latin America, could not be sustained in the long term. In this connection, it should be pointed out that in order to maintain a process of growing external indebtedness, at least three basic conditions must be met:

a) The external economic situation must not undergo any great negative changes which can reduce the capacity of the debtor countries to pay or unduly increase the debt servicing burden;

b) There must be no serious alteration in the readiness of the creditor bankers to provide external financial resources;

c) The resources corresponding to external savings which are obtained in this way must, together with national savings, be used to expand the countries' productive capacity and hence its capacity for servicing the external debt in the future.

Unfortunately, in the recent history of the region none of these three conditions has been fully met. Thus, as regards the external situation, the structural difficulties which affected the central economies meant that they ceased to play their traditional role of driving force of the world economy, so that the "real" conditions which must be fulfilled in order to maintain a growing flow of credit to the countries of the periphery were adversely affected. In addition to these unfavourable effects related to the transfer of capital, the protectionism and high real rates of interest generated by the monetarist-type policies applied in some of the main industrialized countries in their fight against inflation also had negative consequences, as indicated above.

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*/ Between 1973 and 1981 the share of the developing countries in the purchase of exports from the industrialized countries rose as follows: European Economic Community, from 11% to 24%; United States of America, from 21% to 36%, and Japan, from 36% to 45%. In this respect, see the article entitled "Third World takes bigger export share", on p. 6 of the Financial Times of 26 January 1983.

/Secondly, as

Secondly, as regards the readiness of the private banks to go on granting loans to Latin America, it should be recognized that the experience of the 1970s was very special and for that reason difficult to keep up in the long term. Strictly speaking, much of the growth of the external lending to the region represented a process of "catching up" from the point of view of the diversification of the private bank portfolio, following a gap of nearly 40 years. For that reason, during the 1970s, Latin American borrowers were "new" in the eyes of the banks then entering the international scene, so that there was little need for the banks to worry about their exposure. Thus, the growth rate of loans to the countries of the region was very much higher than that of the expansion of the capital base of banks, and this asymmetry, naturally enough, could not last. In practice, the problem of exposure was to become the real obstacle to the smooth transmission of new credit to Latin America.

As regards the economic policies followed by the countries of Latin America, an appreciable number of them used external saving to an appreciable extent to take the place of national saving. Thus, in practice, rather than expanding future production capacity, in some cases external savings merely served to raise the levels of consumption of certain groups in the short term, while in others they contributed to an increase in arms spending.

Finally, it is obvious that some countries of the region did not properly perceive the potential problems involved in a strategy of massive external indebtedness. In particular, they did not take sufficient account of the fact that the "cheap indebtedness" of the past decade, when real interest rates were lower than the historic rates or were even negative in some years, was an artificial situation which could not last for long. Those interest rates were really a consequence of the unexpected acceleration in the rate of inflation in the mid-1960s, but once the creditors adjusted their sights to the probable evolution of prices in the future, real interest rates more than recovered. Furthermore, the relatively long periods of amortization could not be maintained either in view of the heavy risks run by the banks in financing long-term loans with very short-term deposits.

2. The internal causes

As already indicated, external factors have had a prime influence in the gestation and growth of the economic crisis now besetting Latin America. At the same time, however, factors of an internal nature have also had a decisive effect. Of course, the specific nature and relative importance of these factors has been very different in the different national experiences. Thus, in some of them -and especially in some Central American countries- the effects of the profound political changes and the long and painful civil strife which have marked the recent history of some countries of the region have been especially decisive, while in other cases the negative consequences of the shortcomings or excesses of the economic policies applied have played a more important role. Among the latter, two factors which have had a particularly strong impact were the policies of excessive spending followed by some countries, including some of the petroleum-exporting economies, and the monetarist-type policies applied in the Southern Cone economies, based on the principle of great openness to the exterior. Paradoxically, however, the

/prolonged application

prolonged application of these two types of policies, based on very different theories and ideologies, had one major point in common: their dependence on a development strategy which relied excessively on external indebtedness.

a) Excesses in external indebtedness policy

In essence, this strategy was the domestic counterpart, on the one hand of the situation of abundant international liquidity which prevailed between 1974 and 1981, and on the other of the extremely expansive policy followed during that period by the private international banks in their relations with the semi-industrialized countries.

Strictly speaking, it was the interaction between this attitude on the part of the international banks and the external indebtedness strategy followed by many Latin American countries which to a large extent made it possible to mobilize the abundant financial surpluses generated in the international system from the time of the first oil crisis. That interaction also left its mark on the economic evolution of many countries of the region during that period. Finally, it was the abrupt change in the international banks' perception of the viability of development based on this strategy which constituted one of the main factors behind the present crisis.

The underlying foundation of the indebtedness strategy was the simple and not very novel idea of the desirability of supplementing domestic savings with resources from the exterior so as to increase investment and the rate of economic growth. However, the attraction and practical significance of this face of the development process acquired radically different dimensions from around the mid-1970s onwards, when the volume of the external resources available in international capital markets increased and, in particular, when the real interest rates charged for the use of those resources actually became negative in those years.

The possibilities opened up by this new international financial context were initially exploited by many Latin American countries in order to relieve the adverse effects which the recession in the industrialized economies and the sudden and substantial rise in the international price of petroleum had had on the purchasing power of their exports. Thus, thanks partly to the procurement of a greater volume of external resources, in 1974 the region not only maintained a high rate of economic growth of close to 7% but also managed to increase its gross domestic product by close to 4% in 1975. This evolution of economic activity in Latin America was in marked contrast to that of the central countries, where, as already noted, economic activity was quite stagnant during that biennium.

Later on, in spite of the strong and sustained expansion of their exports, the majority of the economies of the region continued to make intensive use of the abundant financial resources offered by the private international banks, with the result that the persistent accentuation of external indebtedness became both a salient characteristic and a basic requirement of their development processes.

The expansion of external indebtedness thus became a double-edged weapon. On the one hand, it made it possible to finance higher levels of imports and capital formation, thereby helping to maintain rates of economic growth in many countries

/that were

that were higher than would have been possible otherwise. On the other hand -and to some extent this was a result of the very dynamism of the external debt as well as of its terms and forms- after a short time the expansion of external indebtedness made it necessary to pay increasingly large amounts to the exterior in respect of interest and capital. Thus, the real transfer of resources represented by a given amount of new loans was rapidly diminishing, whereas there was a marked increase in the sensitiveness of the economy to possible declines in the amount of financing coming from abroad.

This new form of external vulnerability, the real implications of which were, as we have already seen, dramatically revealed in 1982, was not, however, the only negative effect of the exaggerated use of external indebtedness. An additional consequence, less direct but no less serious, was the decisive support given through the excessive use of external resources to the application and above all the prolongation of policies which had a strong influence on the generation of the present crisis, such as those which resulted in a very exaggerated expansion of domestic expenditure and a pronounced drop in the real exchange rate.

b) The over-expansion of domestic expenditure

Although the excessive increase in various forms of domestic expenditure played a paramount role in the inflationary and balance-of-payments crises suffered by many Latin American countries in the 1970s, its impact was especially significant in the events leading up to the current crisis in some of the oil-exporting nations of the region.

In these countries, the boom in the value of exports caused by the rise in the price of petroleum and, in some cases, by the very marked expansion in the volume of external sales, was partly responsible for strengthening the balance of payments and at the same time enormously increasing the public-sector income. The export boom also made for a considerable increase in the confidence of international banks in the growth prospects of the oil-exporting countries, with the result that financial institutions showed greater willingness to channel plentiful additional resources to the countries concerned.

In this context of unprecedented abundance of public and external resources -and of favourable expectations with regard to future trends in the international price of petroleum-, development strategy succeeded in accelerating, likewise exceptionally, the economic growth rate and structural changes in the economy. The main instrument chosen for accomplishing this task was an expansion of public expenditure -both current expenditure and investment- which helped to strengthen the dynamic effects deriving from the external sector.

Stimulated by the buoyancy of global demand, production also grew at an intensive rate. However, owing to the inevitable short-term rigidities in supply in some sectors, and especially because of the unusual rise in the level of production and domestic expenditure, the volume of imports increased even more rapidly. In fact, in spite of the notable upswing in external sales, the import coefficient rose higher than the export coefficient. Nevertheless, financing the trade deficit presented no difficulty, since at the same time the net inflow of capital increased.

/Thus, despite

Thus, despite the steady enlargement of that deficit, international reserves continued to grow, and it was unnecessary to alter the exchange rate, whose real value was, however, declining since, owing to the boom in domestic demand, inflation was speeding up. Since, in addition, the exaggerated expansion of public expenditure was for the most part financed out of resources provided by foreign banks, the external debt also increased at a very rapid pace. In this way, the possibility that the economy could go on expanding without major inflation or balance-of-payments problems became closely dependent on the growth of external indebtedness.

Since the expansion of such indebtedness primarily depended in its turn, on the policies of the banks, which were influenced both by the size of the financial surpluses they could attract and by their assessment of the debtor countries' prospects, the problems implicit in the development strategy chosen by borrower countries began to boom up in mid-1981 when the international price of petroleum ceased to follow a rising trend.

The threat represented by this situation was promptly grasped by many economic agents who opted for a mass transfer of their capital abroad in anticipation of an exchange rate crisis. This attitude, besides causing international reserves to drop still further helped to increase the doubts and reticence of the international private banks, with the result that it became even more obvious that an exchange-rate crisis was inevitable.

In these circumstances, the economic authorities were forced to make a drastic alteration in the parity of their currency to take steps to renegotiate the payments on their external debt and to put strict adjustment programmes into practice. The immediate consequences of these measures were an abrupt acceleration of the inflationary process, a considerable rise in unemployment and a perceptible drop in the level of economic activity, and, in particular, in investment expenditure.

Thus, owing largely to the over-expansion of domestic expenditure and to the phenomenal growth of the external debt which was both cause and effect of that expansion, the period of rapid economic growth, virtually full employment, moderate inflation, abundant supplies of foreign currency and complete freedom regarding the exchange rate, was followed by one of stagnation or recession in economic activity and employment, a crippling shortage of means of external payment and an accelerated increase in domestic prices.

c) Stabilization policies and the lag in exchange rates

Inflation -which up until the beginning of the past decade had been a serious problem only in a relatively small number of Latin American countries- showed a tendency during the period 1973-1975 to become general throughout the region for the first time, and began to worsen again in 1979. Faced with the need to control inflationary processes, which frequently owed much to external factors, many countries applied stabilization policies which, while successfully moderating the rate at which prices increased, were also partially responsible for slowing the pace of economic growth.

/However, it

However, it was in the monetary experiments made by the Southern Cone countries -which at the same time applied strategies aimed at opening up their economies in the areas of trade and/or finance, and at shifting the emphasis placed on the roles of State and market, giving much more importance to the latter- that anti-inflationary policies had their most decisive effect on the gestation, depth and duration of the crisis.

Although the decision to apply these policies was based primarily on a theoretical conception of the way to reduce the rate of inflation, stabilize the balance of payments and manage economic policy, in economies which were wide open to the exterior in the fields of trade and finance, their maintenance over a long period was facilitated by the abundance of external financing which these countries were able to obtain up to 1981. The sizeable external loans they received made it not only possible to cover the increasingly heavy deficits in their balances of payment on current account but also easier to apply an exchange-rate policy whose central aim was to reduce the rate of inflation through its effect on expectations and, primarily, through the limiting of domestic price rises by freedom to import all categories of foreign goods.

In actual fact, in some cases it did prove possible, by virtue of these policies, to meet the objective of reducing the rate of domestic inflation to levels close or equal to that of international inflation. However, partly because this process of approximation took a much longer time than had initially been anticipated, and partly because inflation was already rampant when the exchange rate began to be used as an instrument of stabilization programmes, the policies in question brought about a considerable drop in the real exchange rate.

As was to be expected, this slump in the exchange rate had an unfavourable effect on activities relating to the production of tradeable goods. In the export sector, the fall in the real exchange rate, added to the high domestic rates of interest, reinforced the depressive effects of the international recession and the decline in commodity prices. Its impact was, however, much more adverse in the activities in competition with imports, where exchange-rate policy accentuated, instead of offsetting, the negative effects implied for them by the reduction of tariffs. Thus, at a time when the growth rate of exports was falling, there was an increase in the number and variety of domestic activities which stopped being "competitive" and whose role in meeting domestic demand was assumed by imports. As a result, many enterprises had to lower their level of activity, with the consequent negative impact on employment. Moreover, the heavy real cost of domestic credit adversely affected investment, since there were very few activities whose profits allowed them to pay such high rates of interest.

Naturally, a principal result of those trends was the rapid and persistent enlargement of the deficit in the balance of trade in goods and services. However, since at that time there was still an abundant influx of external financing, this imbalance was not reflected in a loss of international reserves but was in fact accompanied by an increase in them. Another central and no less important consequence was the sustained growth of the external debt and hence of remittances of interest abroad.

/Thus, in

Thus, in addition to the rise in the trade deficit, there was also a rapid increase in payments on foreign capital, which meant that balance-of-payments equilibrium came to depend even more on the constant expansion of the net inflow of loans and investment. A persistent increase in external financing also became the basic requisite for maintaining the exchange-rate policy and therefore for consolidating the progress achieved in controlling inflation.

In 1981-1982, when the evolution of external factors became more and more unfavourable, the use of the exchange-rate policy as an instrument of stabilization programmes was abandoned in one after another of the countries in which it had been applied. In face of new and sharp deteriorations in the terms of trade, an abrupt decrease in the net inflow of capital and a very marked drop in domestic production and employment levels, governments were forced to devalue their currencies severely.

Since this decision entailed a radical change in a policy which had repeatedly been presented as a fundamental element in the economic strategy adopted, its consequences were devastating. The abrupt rise in exchange rates was promptly followed by a notable resurgence of acceleration of the rate of inflation. Moreover, it caused dramatic changes in the net wealth of many enterprises. The hardest hit were those which, in the belief that the exchange-rate policy would hold, had incurred substantial debts in foreign currency. The payments difficulties which such enterprises then experienced bore some of the responsibility for the deterioration in the portfolio of the banks and financial institutions. This situation was aggravated by the loss of confidence and the uncertainty caused both by the abandonment of the exchange-rate policy followed for so long and the lack of a clear definition of the new policy which was to begin to be applied in its stead.

In these circumstances, the inflow of foreign loans decline further at a time when many enterprises owing foreign currency chose not to renew their credits abroad owing to the prevailing uncertainty concerning the future evolution of the exchange parity. This made international reserves fall even further, and thereby aggravated both the balance-of-payments crisis and the contraction in economic activity and employment.

When the undervalued exchange-rate policy was given up, inflation showed a tendency to start climbing again, but now the external debt was much greater, and the economy was therefore faced with the need to generate a large foreign-trade surplus so as to be able to cover debt service payments. This exacting task, whose accomplishment called for a big sacrifice in terms of domestic supplies of goods, at least in the short term, was made even more difficult by the considerable deterioration in the productive capacity of the export sectors and, above all, in that of import-substituting activities.

d) The liberalization of the financial system and the rise in real rates of interest

Another domestic event which was partially responsible for generating and strengthening the crisis was the sharp rise in real rates of interest which followed the financial market reforms introduced in various countries of the region during the second half of the past decade.

/The main

The main objectives of these reforms were to eliminate the existing distortions in the allocation of credit and to promote domestic saving by liberalizing interest rates and expanding and diversifying capital markets.

Up to that point the latter had developed relatively little in many countries, and interest rates, on both the debit and the credit side, were often set by government provisions at what were normally very low levels in real terms. As a result, the credit market was divided between those who had relatively easy access to loans granted at low (or even negative) real interest rates and those who were obliged to finance themselves or to obtain very expensive credits in the informal sector. The low interest rates on loans had a discouraging effect on personal saving and did much to limit the development of financial intermediaries.

In these circumstances, it was assumed that when the activities of the latter were liberalized and the market was left free to determine interest rates, financial institutions would obtain more resources and allocate them more efficiently than in the past. Although it was taken for granted that in order for this to occur, real interest rates would have to rise, it was hoped that they would not be much higher than international interest rates, especially if policies for domestic financial liberalization were accompanied by greater financial openness to the exterior.

In practice, however, after various kinds of "financial repression" had been eliminated, domestic real interest rates rose far above international rates.

This upswing was influenced by various factors, whose relative importance was, moreover, different in the different countries. Thus, in some cases, the liberalization of the financial market coincided with highly restrictive economic policies designed to slow down inflation. In these circumstances, many enterprises increased their demand for credit to avoid the liquidation of their inventories at the much lower real prices which the restrictive policies imposed. In this way, the rigidity in respect of a fall in the market prices of goods pushed up demand for credit, thereby helping to raise interest rates.

In other cases, demand for credit on the part of enterprises expanded because of optimistic expectations concerning the future of the economy -thus furthering a rise in interest rates- and it remained high in spite of the failure of those expectations to materialize, because the accumulated financial costs were so great that new credits were needed to avoid the heavy losses of capital which would have resulted if assets had been liquidated to pay off the debts contracted.

Moreover, the exchange-rate risk necessarily created imbalances between domestic and external interest rates, and this difference tended to widen in so far as the drop in the exchange rate and the resulting decrease in the value of exports, plus the deterioration in the terms of trade, discourage the entry of capital, thereby making a sharp devaluation more and more likely.

Whatever the causes of the rise in the interest rates, the fact is that because of the liberalization of the financial system they did rise to a marked extent, in some countries reaching 2% to 3% a month in real terms. Naturally, interest rates of this magnitude were bound to discourage investment and also, in the long run, to endanger the solvency of enterprises, and therefore that of the financial system.

/Nevertheless, the

Nevertheless, the situation remained tenable while expectations concerning the global evolution of the economy were optimistic and net inflows of capital were high. Primarily as a result of those factors, the values of immovable assets and shares increased at almost the same rate as the debt, or even faster. However, in the end, the accentuation of the fall in the exchange rate, the deterioration in the terms of trade, the drop in the net inflow of capital and the pessimistic volte face in expectations undermined the foundations of the boom, demolishing the value of assets.

Partly on this account, many banks preferred to go on extending credit to companies which had become insolvent, since in the new circumstances, recourse to the guarantees behind the loans meant that the banks would have recover only part of the money lent. In a good many cases this tendency was strengthened by the fact that the firms belonged to the very groups that controlled the banks. Thus, in order to postpone recognition of the loss, many banking institutions and firms kept up the fiction of renewing loans at very high rates of interest which were increasingly difficult to pay.

Finally, some banks became insolvent. To cope with this situation, the governments intervened in their support so as to avert a crisis in the financial system. But this made inflation and its consequences much worse and necessitaded the provision of a State guarantee for those debts which the banks held abroad.

Thus, essential though it was for the financial system to be in some measure liberalized for the sake of its growth and diversification, the actual methods by which the reforms were carried out sometimes led to exceedingly high rates of interest and disproportionate levels of internal and external indebtedness which in the end jeopardized the solvency of companies and banks. In this way, the measures designed to promote the development of the financial system paradoxically precipitated its crisis and aggravated the outflow of capital and the recession.

Chapter II

THE CHALLENGES OF THE CRISIS AND INTERNATIONAL ACTION IN LATIN AMERICA

A. The need for concerted action

To overcome the serious short-term problems posed by the adjustment process, and to do so in harmony with the new long-term approaches to development and to external insertion which the Latin American countries will have to adopt in facing up to urgent social requirements and adverse international conditions, it is essential that the countries of the region should withstand the temptation to be pre-eminently adaptive in their dealings with the exterior and that instead they should take immediate, well thought-out and imaginative action at the international level. The success they achieve in their action on the external front will basically depend first on the industrialized countries' understanding of the need to seek an in-depth solution to the problems faced by Latin America today, and secondly on the capacity for concerted action actually shown by the Latin American countries in the international field.

The possibility of advancing towards the fulfilment of the first of those conditions is grounded on the fact that, notwithstanding the structural asymmetry which characterizes relations between the industrialized countries and the countries of Latin America, they now have basic interests in common, which is obviously of importance whether the present crisis is surmounted or whether it becomes radically worse. Actually, in the period prior to the present recession, Latin America was one of the most dynamic markets for the products of the central economies, and especially for their exports of manufactures. Hence the industrialized countries' objective interest in the resumption of the economic growth of Latin America.

In the document entitled "Hacia la recuperación económica y la equidad social", prepared for the Meeting of Personalities, at which this report also is to be presented, Dr. Raúl Prebisch stresses the reciprocity of interest which now exists between the two groups of countries, setting it against the backcloth of a broad historical perspective.

> "The periphery had been characterized by its passive role. In the bygone times of outward-directed development, its growth rate depended basically on that of primary exports to the centres. Afterwards, thanks to its industrialization, it was able to accelerate the pace of growth through import substitution, but without coming to play a dynamic role in relation to the centres. Now, on the basis of the experience acquired in export substitution, the periphery has begun to display its own aptitude for exporting manufactures. And this is a primordial factor in its dynamic role. But in what does that role consist? The explanation is very simple. The periphery has a huge potential demand for goods with a high technological coefficient which the innovations of the centres are incessantly diversifying. And the greater its effective capacity to meet this demand by purchasing exports from the centres, the more intensive will be its dynamic role in relation to their development."

/In turn,

In turn, as has already been pointed out, world economic growth would gather decisive momentum if the recovery of economic activity in the industrialized countries were extended and strengthened, which would also be of considerable benefit to the periphery.

The existence of interests common to the industrialized countries and the economies of the region becomes even more apparent if the present crisis is assumed to gather force, leading some Latin American countries, for example, to declare a moratorium on their external debt payments. In that event, not only the stability of the international financial system but also the viability of some of the largest banks in certain industrialized countries would be affected, with incalculable economic and political consequences. This possibility has been grasped and acknowledged in eloquent terms by Mr. Henry Kissinger, the former Secretary of State of the United States, who recently said that creditors and debtors were both caught in the same system in which a disaster suffered by one of the parties would be the ruin of them all. The creditors could not suspend the credits granted to their debtors without incurring the risk not only of a bank disaster but also of a worsening of the recession. He suggested that the real objective should be to promote the sustained growth of the developing countries; otherwise the most frenzied renegotiations of the external debt would only postpone the inevitable crisis.

However, in addition to the need for a favourable reaction on the part of the developed countries, the Latin American countries themselves, if they are to weather the crisis they are facing, must co-ordinate their external policies much more efectively.

The first reason for this is that more closely concerted action by the Latin American countries in the fields of trade and finance would help to bring out the considerable relative importance of their aggregate economic expansion for the evolution of the economic activity of the developed countries, whereby their bargaining power vis-à-vis these latter would, of course, be enhanced. Secondly, the constraints encountered by Latin America in its external sector have made it more than ever apparent that there is a need to strengthen intra-regional co-operation, which, by definition, entails concerted action by the countries of the region. The third reason is that whatever the room for manoeuvre available to each Latin American country may be (and this of course differs greatly in each case), it will tend to widen through more concerted action, and conversely, would shrink in a scenario dominated by bilateral and competitive policies.

In brief, the present crisis, besides pointing clearly to the need for the Latin American countries to strengthen their capacity to take concerted action, provides an opportunity for this to happen. First and foremost, in the external sector, because the basic causes of the grave situation prevailing in the region are also external. And then at the regional level, because there can be no doubt that the discouraging prospects for the world economy will continue to give rise to constraints which will make it essential for the Latin American countries to experiment with development strategies increasingly based on the use of their domestic resources and markets both at the national and at the regional level.

/B. Action

B. Action at the international level

1. Basic options in the external sector

The most troubling manifestation of the crisis lies in the heavy burden which the volume and terms of their external indebtedness lays on the Latin American countries. For this reason, in the short term, the response to the crisis will depend basically on whatever possibilities exist for lightening the load.

Two possible ways of servicing the debt are by achieving a balance-of-trade surplus and, in the short term, by drawing on international reserves. However, because of the unfavourable trends in the world economy and the effort already made by the Latin American countries to adjust to the situation by compressing their imports and by using their reserves, the viability of both approaches is exceedingly slight. Thus, the disturbing alternative left open is that either these countries will in the short term be forced to carry adjustment measures to the extreme -which would intensify the recession, with the serious economic, social and political consequences that would be involved-, or that they will unilaterally declare a moratorium, as a large majority of them did in the 1930s.

The line followed by the Latin American governments since mid-1982 indicates, however, that they are determined to avoid taking the latter way out although it is also clear that many of them might not be able to cope with the consequences of the application of even more recessive adjustment policies.

Moreover, both the moratorium option and that of giving impetus to the recession would be thoroughly prejudicial in terms of stability of the international financial system and the prospects for the recovery of the world economy. For that reason, the most rational formula to enable not only the Latin American countries but also the developed countries to stay out of harm's way would be for the amortization payments and the majority of the interest payments on the external debt to be rescheduled in accordance with more expeditious procedures and on less burdensome terms than those which have prevailed in the renegotiations held so far; and for the debtor countries, their creditors and the financial authorities of the industrialized countries to come to an agreement.

Paradoxically, this solution would occasion an additional increase in the region's external debt, for the next three years at least. Hence, if it were prolonged for some time, the debt problem would again confront the Latin American countries, perhaps in a more serious form than now. This is why, in addition to the essential measures which must be adopted immediately in the sphere of finance, it is also necessary to act promptly and decisively in the field of trade, since it is from that sector that in the last analysis the resources needed for gradually resolving the problem of the excessive debt burden will have to come.

This action in the areas of finance and trade must, moreover, be accompanied by structural changes in the development strategies of the Latin American countries, aimed at basing economic growth more and more on utilization of the countries' own markets and resources: changes in which, as will be seen in the last section of the present chapter, the expansion of regional economic co-operation is called upon to play a decisive role.

/2. Action

2. Action in the financial field

a) Renegotiation of the debt; the amounts required

In view of the fact that both an accentuation of the recession in Latin America and the moratorium alternative to it would jeopardize not only the interests of the countries of the region but also the operation of the world economy, the adjustment in the Latin American countries should be made in such a way that in the next two years not only would progress be made in the reestablishment of external equilibrium but it would be possible at the very least to maintain the per capita product, which as has already been seen, declined in nearly all the countries of the region in 1982 and is likely to fall yet again in many of them during 1983.

In present circumstances, the attainment of this objective will depend in substance on the Latin American countries' possibilities of servicing the debt. For the reasons mentioned above, the possibility of financing the payments involved with a balance-of-trade surplus or by a further reduction of international reserves are, in general, very limited; in the next few years, therefore, the need to attract a greater inflow of capital will be ineluctable. This in turn poses problems as to the volume of the net intake of external resources, their costs and the most appropriate ways and means of obtaining them.

To make an approximate estimate of the amount of external financing required to keep up the level of the per capita product during the period 1984-1985, a scenario based on three main assumptions has been considered. The first is that there will be a period of moderate reactivation in the developed countries. The second is that even if between 1983 and the end of the decade world trade were to grow in real terms at a rate somewhat higher than that of the economic expansion of the developed countries, the uncertain and mediocre prospects offered by the reactivation of these latter combined with the fact that the Latin American countries could benefit only partially by the increase in world trade because of the trade restrictions currently in force, would slow down the annual growth rate of Latin American exports. The third and last assumption is that in what remains of the decade the performance of the region's imports will lie halfway between what it was during the period of severe restrictions in the 1950s and what it was during the time of easy and plentiful external supplies in the second half of the 1970s.

Given these assumptions -which must of course be used with caution, in particular because of the prevailing uncertainty as regards the immediate prospects of the industrialized countries and the fact that the region's volume of imports declined sharply in 1980 and 1982-, the gross inflows of capital required to maintain the per capita product in the Latin American countries during the next two years would be roughly equivalent to the debt amortization payments plus the payment of most of the interest and profits. In other words, during the period 1983-1985, net inflows of external resources would need to be equivalent to the net payments or remittances that would have to be made under the two last-named heads, and would amount on an average to something over US$ 35 billion.

If, on the other hand, it is assumed that during that period imports will continue to behave as they have in the past 10 years, the external financing needed to maintain the per capita product will be substantially greater, probably hovering around US$ 50 billion a year.

/To appreciate

To appreciate the significance of these figures, it must be borne in mind that the external financing of close to US$ 35 billion required under the first hypothesis as to the probable evolution of imports is nearly twice the amount recorded in 1982 and is probably also considerably higher than is at present expected by the international private banks.

b) Renegotiation of the debt: the costs and their distribution

But the problem of lightening the burden of debt payments is not confined to the necessity of rescheduling its repayment periods. Equally great is the need to reduce the costs of rescheduling and to distribute them more equitably among the debtors, the creditor institutions and the developed countries.

The renegotiations carried out so far have not only been slow and uncertain but have given rise to substantial additional costs for the debtor countries. The international private banks have taken advantage of the rescheduling to boost the price of external credit. This is a very questionable practice since in theory the main reason for a rise in the price of credit should be an increase in the risks incurred by the lender. In the event of a rescheduling agreement, the risk of non-fulfilment not only is no greater, but is in fact lessened. Thus, in practice there has been a tendency to pass much of the cost of a weak loan portfolio along to the debtors at the very time when the risks attached to such loans are being reduced through rescheduling.

The asymmetry now present in the distribution between creditors and debtors of the costs of renegotiating the debt is in sharp contrast with what happened during the 1930s. At that time, the external Latin American debt had been contracted primarily by floating in the international capital markets bonds to which countless investors large and small, subscribed. These bonds were traded in the stock exchanges, and one of the factors determining their price was the risk of non-payment. When the Latin American countries faced dramatic external problems because of the depression, the price of the said bonds plummeted and, as a result, when the countries reinitiated payment on their external debt, they were able to buy back the bonds at a price very much lower than their value at issue. In this way, the cost of the adjustment was distributed between creditors and debtors on the basis of appraisal of the risk prevailing in the international capital markets. Nowadays, in contrast, the creditors are basically the commercial banks whose portfolio of assets is not easily traded, and for which its liquidation would represent losses so substantial as to jeopardize the banks' own stability and that of the world financial system.

Moreover, the experience of recent years shows that private banks have not clearly understood the difficulties now facing the developing countries in terms of servicing the debt. Actually, when problems first arose, the banks resigned themselves to rescheduling the debt already contracted in order to avert a stoppage of payments. But they did it in such a way as to minimize their own risks, maintain or increase the returns on their assets and impose a measure of "discipline" on the borrowers. In this way, refinancing was granted on a restrictive basis, with short maturities, high interest rates and burdensome commissions. For this reason, rescheduling, instead of helping to prevent additional deterioration of the debtor country's growth rate, basically provided stopgap solutions, which involved additional costs for the borrowers and made their growth prospects even dimmer.

/This state

This state of affairs is inadmissible, since the private international banks must assume their share of responsibility for the difficult situation that has been created. At the expansionist stage of the credit cycle, they competed very actively for rapid investment of the financial surpluses obtained in a time of unprecedented international liquidity, granting large loans at low rates of interest, which, owing to the variability of these rates, turned out to be highly dangerous for the debtors.

The need to secure a more evenly balanced distribution of the costs of adjustment is also borne out by the effects that a potential cessation of payment on Latin America's part would produce. As has already been pointed out, it would result in a severe crisis in the international financial system, since cessation of payment by a debtor country of some importance or a group of smaller debtor countries would have serious repercussions on the solvency of many private banks, whose operations are essential for the normal running of the economy of the industrialized countries.*/

Moreover, as was said before, a Latin American payments crisis not only would affect the international financial system but would also reduce the prospects of recovery of the international economy as a whole, since it would have a severe impact on the export sectors of the industrialized countries.

Referring precisely to the interests which would be affected, Mr. Donald Reagan, the Secretary of the Treasury of the United States, recently said it was legitimate for the citizens of the United States to wonder why they and their Government should worry about the problem of the international debt. "Why", he asked, "should we care that a few foreign borrowers are being denied bank loans or that the banks are losing their money? Nobody forced them to make the loans, and they should accept the consequences of their decisions as in any other business deal". He said that if the Government of the United States had nothing else in mind than to give money to the borrowers and those from whom they borrowed, it would be hard to justify the use of United States funds in efforts to resolve the debt crisis, especially at a time of adjustment in domestic expenditure. But there were, of course, more angles to the problem and its solution. First, another sudden and large-scale contraction in the imports of the less developed countries would be highly prejudicial to the economies of the United States. Secondly, if the situation were not dealt with appropriately, the situation of the borrowers in less developed countries would become so impossibly difficult that they would be tempted to adopt desperate measures to get out of their predicament.**/

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*/ In this connection, it would be useful to bear in mind that the loans made by North American banks to borrowers in Brazil and Mexico alone represent close to two-thirds of the capital of all the banks in the United States.

**/ Statement by Mr. Reagan to the Banking Committee of the United States House of Representatives on 7 April 1983.

/Moreover, the

Moreover, the rescheduling of debts and the extension of their amortization periods on softer terms, which take into account the borrowers' real payment capacity, is already a common experience for private banks in the domestic markets of the developed countries, and has occurred, for example, in the United States with trust funds for investment in real estate and the Chrysler Corporation rescue operations. The application of similar practices at the international level would be very beneficial in that it would give criteria relating to the growth capacity of the developing countries much greater weight than has so far been the case in the rescheduling of their debts.

Nor can it be doubted that the Treasuries and Central Banks of the developed countries will have to make a bigger contribution to the implementation of the measures needed to solve the crisis, as they have already been doing to some extent in the past year, either bilaterally or through the Bank of International Settlements at Basle. This need has been emphatically recognized by Mr. Helmut Schmidt, the former Chancellor of the Federal Republic of Germany, in a persuasive article which was published in the leading specialized periodicals of Europe and Japan, and in which he expresses the view that recent experience with respect to external indebtedness awakens a suspicion that many commercial banks over-expanded their international lending in the 1970s and that the Central Banks and the governments neglected their supervisory functions and allowed their role of "lenders of the last resort" to become obscured. He added that it would be a mistake to conclude from these examples thet the international banks and the financial system were incapable of solving the difficult problems which the present world economic situation had laid upon them. However, all the parties involved -the central banks, the governments, the multilateral organizations and the international private banks- would have to make a drive in the same direction.

In this regard, it must be acknowledged that the rescheduling procedure has shown some improvement thanks to the International Monetary Fund's insistence that the safeguard clause offered by the private banks be compatible with the goals in its stand-by programme for the country concerned. However, in essence, rescheduling still has makeshift features and involves high costs for the debtor countries in terms both of the commissions charged by the private banks for carrying out the rescheduling and of the sacrifices it requires of them from the standpoint of development. Although the Fund's approach is leading in the right direction, its impact is still too slight, and will remain so as long as criteria relating to the debtor countries' growth capacity are not given greater weight in the Fund's appraisal of the situation in the various countries.

Strictly speaking, if the costs of adjustment are to be reduced and redistributed more equitably between creditors and debtors, a new set of requirements must be established in negotiations for the rescheduling of debt payments. First, the debtor country should seek to obtain the reduction or elimination of the additional costs involved in rescheduling, which should be regarded as a debt management measure and not as an additional financial transaction. Moreover, those countries should stress the need for longer maturities (five years, for example) so as to reduce the uncertainty and the effort and tension which renegotiation for shorter periods involves. This would clearly be to the benefit not only of the debtors but also of the creditors.

/These criteria

These criteria would probably be more readily accepted by international private banks if the renegotiation agreements included a bisque clause in which a certain degree of flexibility were incorporated into the schedule of reprogrammed capital and interest payments. This clause would specify that the schedule would depend on economic trends in the borrower country, so that if conditions improved, a proportion of the benefits of the more favourable situation would be shared with the creditor banks through acceleration of amortization and interest payments.

c) The renegotiation of the debt: additional machinery

In addition to the criteria suggested above to ensure that the external debt is reprogrammed more appropriately, from a broader viewpoint thought should be given to other options which facilitate or supplement the procedures referred to.

The first of these would be the issue of bonds or other first-class documents by the debtor countries which would be tradeable in the secondary capital markets and would be turned over to the private banks to cover part of the interest and amortization payments owed.

The second would be to transfer sizable proportions of the portfolio of loans made to Latin America by international private banks to the World Bank, IDB or other multilateral financial bodies. These institutions would purchase the loans in question with the corresponding discounts. Thus, some of the region's indebtedness problem would be carried to the level of the international public bodies. As a result, credit terms would improve, and the risks involved might be viewed in a broader perspective than that at present characterizing the private banks, which has had a strong influence on the escape mechanisms tried out hitherto.

A third possibility would be the creation within the International Monetary Fund of a special service for financing the proportion of balance-of-payments deficits that was attributable to undue increases in international interest rates. This service would provide for compensatory loans to debtor countries during those periods in which international interest rates exceeded their traditional levels.

A fourth way of approach to the same objective would be the improvement of the operational policies and procedures of the World Bank and IDB through more expeditious disbursement of loans already approved; reduction of requirements with regard to counterparts in national resources; willingness of the Banks to finance a larger proportion of local costs; adoption of margins of preference in favour of Latin American suppliers or more comprehensive programmes for the financing of exports of capital goods of regional origin; greater openness to the financing of programme loans, etc.

It would be indispensable for the measures suggested above to be accompanied by the adoption of better internal regulations concerning the use of international credit, to safeguard the maintenance of an appropriate balance between the amount of the debt and the country's payment capacity and to promote the effective application of criteria for social evaluation of the projects towards which external credit is channelled.

/Last but

Last but not least, a regional information and co-operation centre or mechanism might be created to concern itself with trends in the international financial markets, the behaviour of individual creditors, the modalities of renegotiations under way, the opportunities for access to new credits, and so forth. While a system of this kind could not be directed towards co-ordination of the various Latin American countries, negotiations for the reprogramming of their respective debt, since each of these exercises reflects a different situation and must be conducted independently, it could on the other hand be used for comparing and, where possible, harmonizing general criteria relating to costs, maturities and other terms being renegotiated.*/

d) Action in the field of development financing and the international monetary system

The present international financial crisis has its roots in the virtual disintegration of the principles established at Bretton Woods, which were a powerful factor in the stability of the world economy and promoted unprecedented global growth and prosperity during the postwar period. Thus, as a more permanent solution to the present difficulties and the problems connected with the rescheduling of the external debt payments, measures relating to the reform of the international monetary system and to development financing are necessary.

Mention has already been made of the need to promote the strengthening and improvement of the existing multilateral financial institutions. Unfortunately some influential circles in the industrialized countries have a mistaken idea of the role of these institutions, which are frequently seen as mere agents for granting subsidized credit. The truth, however, is very different: owing both to their need to make a careful appraisal of the risks of their transactions and also to their excellent technical capacity, these institutions establish criteria which introduce a considerable element of stability into the world financial system. In this respect they are in the best possible position to play a significant anticyclical role, which could counterbalance the procyclical outlook of the private banks. In addition, the strengthening of the multilateral financial institutions and the appropriate modification of their operating conditions would promote greater confidence in the private financial markets, thereby attenuating the upheavals recorded in recent years in the volume and terms of the capital movements concerned -all of which would benefit developing and developed countries alike.

Unfortunately, the financial capacity of the multilateral institutions has weakened in recent years.

The International Monetary Fund has exhausted its resources, while the recently approved increase in its quotas will come into effect only at the beginning of 1984, and even then will not exceed 20% of the deficit foreseeable for that year on the current account of the developing countries.

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*/ The organization of such a system could be entrusted to existing regional co-operation bodies such as ECLA and CEMLA, and could be assisted by the existing regional associations of financial institutions, both commercial and development-oriented (FELABAN and ALIDE).

/The contributions

The contributions of the World Bank and IDB to the financing of the region have also contracted markedly in relative terms: as a percentage of the Latin American countries' deficit on current account, the value of the loans authorized by IDB fell from an average of 25% in the period 1965-1970 to one of 11% in 1975-1980, while the share of the World Bank declined from 21% to 12% between those two periods. Hence the resources available to those institutions for loans to Latin America should be at least doubled if they are once again to contribute a reasonable proportion of the flows of external resources needed by the region, and are to be able to help it to reduce its deficits on current account, as they used to do in the past.*/

Moreover, it would be desirable for the International Monetary Fund to take a more flexible view of how the adjustment processes should be carried out in such a way as to be better adapted to the political and socio-economic objectives of its member countries, which are becoming increasingly heterogeneous. This means relying less on automatic adjustment by means of incentives tied to private market prices and giving more importance to the State and to direct adjustment instruments capable of affecting the main economic variables. Such a modification of the Fund's criteria would also have the advantage of influencing the attitudes of the private banks and would tend to ensure that both its own action and that of the banks in question were more compatible with the development objectives of the debtor countries and with requirements for world economic reactivation. In this last connection, IMF should also have mechanisms for promoting the adjustment of the external accounts of the countries with surpluses so that the cost of the global adjustment would be shared more equitably between those countries and the deficit economies.

It is also obvious that an increase in international liquidity through the allocation of new Special Drawing Rights would be a very good idea. At the present time, private banks are facing serious portfolio problems, and therefore are not providing the international monetary system with the fluidity they supplied in the 1970s. In addition, official world reserves fell sharply during 1982 and continued to decline at the beginning of 1983 -a phenomenon which naturally has a debilitating effect on any tendency towards reactivation. An additional allocation of Special Drawing Rights would compensate for this reduction in reserves and would help both to stimulate the world economy and to redistribute the burden of external adjustment more equitably. Another advantage of an allocation of this kind is that it could be arranged for a much shorter time than that needed to increase the regular resources of the International Mobetary Fund.

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*/ Attention should be drawn to the fact that IDB has encountered difficulties in increasing its regular capital resources notwithstanding that a large majority of the member countries of the Bank have strongly supported that exercise. The difficulties experienced by a few individual countries in making contributions to institutions such as IDB at a rate similar to that which other countries are ready to keep up in order to maintain those institution's capacity to meet the financing needs of Latin America during a particularly trying period should be no obstacle to the expansion of their resources. To that end, special funds could be set up within the institutions, with the participation of the contributing countries, or -if no other solutions were feasible- their share capital could be restructured in such a way that participation in it could be increased in the case of those countries which were ready to provide a larger quota of resources.

/Finally, it

Finally, it seems indispensable to encourage the establishment of new operational mechanisms, within the multilareral institutions which already exist, as a means of co-operating with the developing countries in the process of rescheduling the payment of their external debt. A joint International Monetary Fund/World Bank service for refinancing the debt, to which the countries could have voluntary and automatic access on the basis of objective indicators, and which would provide support to any country on the basis of case studies, would be a decisively important link in the chain of international co-operation. To establish this new service use could be made of a significant proportion of any Special Drawing Rights which may be allocated in the future, and of resources from the creditor banks.

3. Approaches in the field of trade

a) Openness and diversification of markets

As has already been discussed, one of the fundamental characteristics of the new development pattern which the region must follow in the future will be less dependence on external financing. In addition, to increase the autonomy of national development, it is obvious that in the medium term the countries of the region should strive to reduce the relative weight of debt servicing. But this in turn will crucially depend on the evolution of their foreign trade and especially on how successful they are in increasing their exports.

In this connection it must be recognized, however, that the modest prospects for the world economy and the slow pace at which international trade is likely to grow over the next few years will continue to be severely limiting factors, whose effects are likely to be aggravated by those of the neo-protectionism which the central countries are increasingly practising.

As a consequence of these trends and policies, the opening-up of trade which had characterized the evolution of the economy of the centres since the end of the Second World War has lost momentum and potential, and this has jeopardized progress towards a new international division of labour at the world level, a process which had been precisely one of the opportunities open to the developing countries prior to the recession. At the same time, the trade liberalization norms which governed international trade during the past 30 years have been replaced by an increasingly motley collection of protectionist, discriminatory and not very limpid measures which have meant that the exceptions to the GATT rules are now applied to a very high proportion of world trade.

In the markets of the industrialized countries, Latin American exports have traditionally run up against sliding-scale tariffs -based on the degree to which the goods exported have been processed- and non tariff barriers which are severely restrictive and discriminatory. To these protectionist measures has been added other specific machinery, usually of a non-tariff nature, including in particular the unilateral application of safeguard clauses; the obligation to subscribe to official or private agreements among the various trade partners designed to ensure what is known as "market organization", the adoption of "voluntary restrictions" on the export of some countries which are making a drive

/for accelerated

for accelerated industrialization; the use by the developed countries of export subsidies and domestic price support policies; and the enforcement of compensatory duties on Latin American exports when the industrialized countries unilaterally judge them to have been subsidized.

The scope and impact which these protectionist measures as a whole have attained is fully apparent when it is recalled that in recent years, according to pertinent calculations, close to half of Latin America's exports (excluding petroleum) to the United States, the European Economic Community and Japan were subject to non-tariff barriers.

These new types of protectionism (and others which it would take too long to list) are gradually leading to a situation in which a growing share of trade between the developed and the developing countries -the Latin American developing countries in particular- is channelled through various forms of "managed trade". In addition, the industrialized countries regulate the intensity of the "management" involved, applying it either sporadically and selectively or more fully, frequently and systematically.

This protectionism on the part of the industrialized countries seriously reduces the Latin American countries' chances of lightening the external debt burden in the medium term through the application of measures such as those proposed in the preceding section. It is also reminiscent of the unhappy experiences which led to the world economic and political collapse in the 1930s. As the former Chancellor Helmut Schmidt discerningly remark in the article cited above, credit creates trade, and trade ensures credit. "The balance-of-payments problems of the leading developing countries", he says, "cannot be remedied if we close our markets. Today the developing countries are in a position similar in many respects to that of the German State in the 1920s: Germany could not honour its 'reparations' payments because the Allies were not prepared to tolerate a German trade surplus. That is why Germany could not pay its debts and lost its credit".

Various ways of correcting this situation can be suggested, In the first place, Latin America should take concerted action vis-à-vis certain types of sliding-scale tariffs and non-tariffs restrictions which are put into effect by the developed countries (and many of which were recognized in the codes of conduct that were approved at the last GATT meeting) and should strive to obtain their reduction and gradual elimination. The pursuit of this objective is an arduous and complex task, and it will be difficult to achieve significant results in the short term. Nevertheless, Latin America must continue applying pressure, in co-ordination with the Group of 77, to see that these matters are considered in the context of GATT. As a complement, the institutional framework afforded by UNCTAD provides a good alternative for the identification of the problems arising in this connection and for the adoption by the developping countries of common positions, the relevance of which is enhanced by the fact that the sixth world conference of this organization is being held in June 1984.

/Secondly, it

Secondly, it is of great importance for Latin America that a new safeguard-clause mechanism be approved. This should be designed to cope with exceptional circumstances affecting importer countries and should not allow them to restrict without real justification the entry of products habitually exported by the Latin American and other developing countries to the industrialized countries. On these grounds, the region should firmly support the negotiations which, in accordance with the latest Ministerial declaration of GATT, are to begin in 1983 and end in 1984, and which are aimed at defining and adopting a new code for safeguard clauses.

Thirdly, the Latin American countries must unite to combat one of the most harmful forms of protectionism with which they are now faced, i.e., the subsidies that the developed countries are granting on production and exports from such basic sectors as agriculture, livestock production and important branches of industry. The distortions caused by these practices take the form, on the one hand, of lowering the prices of the subsidized products which reach the Latin American markets, thereby artificially reducing the competitiveness of the region's own products, while on the other hand, they permit subsidized products to compete on the markets of third countries with other products in which the region has obvious comparative advantages.

It must also be noted that, at direct variance with these practices, the industrialized countries keep a watchful eye out for the use of subsidies by the developing countries, applying compensatory duties on imports of products which they think have been subsidized and denouncing in GATT the violation of the corresponding code in cases in which such products are imported by other markets which they themselves wish to supply.

This policy looks even more questionable if it is borne in mind that in the developed countries subsidies are basically a way of protecting inefficient and obsolete lines of production, whereas in Latin America they are primarily used to promote relatively new export activities in which the countries of the region can acquire comparative advantages and which have great potential from the point of view of strengthening production capacity and technological development.

Accordingly, this is one of the topics which should be given priority and negotiated with the developed countries, as a matter of urgency, in the proper forums, since the code of subsidies which now stands is inappropriate and of little efficacy.

While these negotiations are under way, some additional operational machinery may be needed, which could be set up within UNCTAD. This machinery could facilitat the study and inventorying of the subsidies applied by the developed countries, the evaluation of their impact on the economies of the developing countries and the search for solutions to the problem, including the determination of possible compensation which the industrialized countries should make to the developing countries for the damage caused by their subsidy systems.

The fourth point for consideration relates to the need to broaden the benefits derived from the Generalized System of Trade Preferences (GSP). The many limitatior from which these systems suffer from the standpoint of their transitory, selective

/and unilateral

and unilateral character, the origin and volume of imports allowed under them and the graduated scale established for their application to the various countries have caused a great deal of frustration. Nevertheless, these systems represent one of the greatest conquests achieved by the developing world through UNCTAD. There is a pressing need, therefore, to perfect them within that same multilateral forum, and to do so, persistent joint action an the part of the Latin American countries is necessary. However, the most important negotiations in this respect will have to be of a bilateral nature, i.e., with each of the countries or regions of the industrialized world which have a generalized system of preferences in force. These negotiations should be initiated as a matter of urgency by all the developing countries with the object of ensuring that those systems make a growing contribution to the opening-up and enlargement of the markets for Latin American exports, especially manufactures and semi-manufactures.

Fifthly, and on a broader plane, in view of the extent and depth of the erosion of the principles and standards governing the system of international trade, it is indispensable to persevere in the structuring of a new trade system which in the first place is global in the sense that it embraces all branches of merchandise trade, and, secondly, is universal in its coverage, gradually taking in all the countries, including those with a centrally-planned economy.

The principles, standards and mechanisms established by such a system should meet the needs of the different groups of countries, so that consideration should be given to special and differential treatment for the developing countries -a principle which was approved at the Tokyo round of multilateral trade negotiations, but has not been carried to completion in practice.

There is a clear need to expand trade between the Latin American countries and the other developing countries. The relevant data available make it possible to predict that during the rest of this decade interregional trade could expand significantly and steadily. Between 1970 and the beginning of the present decade, Latin American exports to all the other developing countries rose from 2% to 5% of the total exports of the region. The latter figure, which still seems relatively low, could be substantially increased during the 1980s, especially in view of the fact that Latin American exports to the rest of the developing countries have represented less than 2% of their total imports in recent years.

b) Strengthening of joint action in Latin America

The growing tendency of the industrialized countries to channel their trade relations through various "managed trade" modalities based on the influence which those countries have in the international system and not on the norms which up to now have governed the system of world trade is yet another reason why the Latin American countries should strive to co-ordinate their action in this field more closely. This would undoubtedly result in a strengthening of bargaining power in the realm of international trade relations.

An essential task which should be undertaken in this connection stems from the need for the Latin American countries to take organized steps to profit more from their bargaining power through the establishment of a regional trade information system which would enable them to keep constantly up to date not only

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as to the trade performance of the industrialized countries and the evolution of their markets, but also with regard to their own possibilities in this field, at a sufficient disaggregated level. The establishment of a mechanism of this kind would, among other things, allow progress to be made towards securing more symmetrical treatment for exports from developed countries that put protectionist measures into force. It is obvious that to respond to those measures a first requisite is to have a supply of timely and accurate information concerning the characteristics and scope of the protectionist instruments applied by the industrialized countries, and also data relating to the products or groups of products in which the Latin American countries would be capable of undertaking compensatory action. The mere increase of that capacity by virtue of a system of up-to-date trade information could facilitate the cessation of trade hostilities on the part of the industrialized countries and induce a search for solutions which better reflect the interests of all the parties involved.

Needless to say, a regional information system such as the one suggested could be of inestimable utility in other areas in addition to the one already suggested. In institutional terms, the collection, management and evaluation of the information required for the establishment of a system of this kind, as well as the definition and actual approval of the measures which would have to be taken to create it, could take place within the framework of regional institutions now in existence.

As everybody knows, the role played by the transnational corporations in the operation of the Latin American economies is of great significance, although naturally there are differences in the traits characterizing their behaviour both in the diverse national cases and in the various productive activities. This behaviour is especially influential in Latin America's foreign trade. For that reason it would be recommendable for national authorities to incorporate into their foreign investment policies measures to ensure that the transnational corporations gradually attain certain goals in this connection and generate increasingly positive results in the trade balances of their operations. These measures should aim at stimulating the corporations' exports potential and at the reduction of their imports. In particular, policies concerning the exports to the developed countries required of the transnational corporations should be in accordance with a selective strategy defined sufficiently far in advance, and taking into consideration such aspects as the establishment of adequate incentives, the simplification of the administrative operations involved, and appropriate follow-up of the transactions carried out. As for the reduction of the imports of these corporations, it might be achieved by, inter alia, greater use of local inputs or components in their productive operations and the setting of ceilings on their imports.

The strengthening of concerted action in Latin America is particularly necessary in connection with commodities, which still represent close to 80% of the total value of Latin American exports, or about 40% if petroleum is excluded. Thus there is an obvious need to increase their value by defending their international prices and by subjecting them to a higher degree of processing.

/However, in

However, in spite of the important role played by commodities in the developing countries, it must be acknowledged that the main agents in world commodity trade are the market-economy developed countries, which account for about 50% of world exports and absorb more than 70% of total imports of primary products. This means that in the specific case of some commodities, such as grains and cotton, for example, the success of the measures proposed at the international level will depend on the degree to which the developing countries can organize their bargaining power so as to balance that of the industrialized countries, whether they are bargaining as producers or as consumers. For these purposes, there would seem to be a need for Latin America to draw up differentiated policies for each commodity or group of commodities in accordance with its own characteristics, the kind of action or measures best suited to it and the role which the region can play in each case.

It is also important for the Latin American producer countries to demonstrate in their negotiations with the consumer countries that an option exists which is different from that represented by the traditional international commodity agreements. For example, should those agreements between producers and consumers not be viable, recourse could be had to the organization of producers' associations which would pursue similar objectives. In that respect, there is an urgent need to broaden and strengthen the bargaining power of the producers' associations existing in the region (the Group of Latin American and Caribbean Sugar Exporting Countries (GEPLACEA), the Union of Banana Exporting Countries (UBEC) and the Multinational Banana Marketing Company (COMUNBANA)), in order that their success may set an example for the creation of similar bodies in the case of other commodities of importance for Latin America.

Experience has shown that efforts to find solutions to many of these problems exclusively within the framework of a commodity agreement are probably doomed to failure. Accordingly, there is an obvious need to venture beyond commodities as such and to approach negotiations with the consumer countries on a broader front. Latin America's aggregate purchasing power could of course weigh very heavily at a negotiation table. Likewise, in view of the close connection that exists between trade problems and the problems relating to the debt, it should be recognized that the ability of Latin America to service its debt depends largely on its possibilities of achieving significant increases in its export earnings, which, in their turn, are closely dependent on trends in volumes sold and in international commodity prices.

Finally, commodity export strategy should systematically incorporate as one of its basic dimensions, increasing degrees of local processing and marketing of primary products. The policy measures formulated in this connection, some of which will concern the operations of the transnational corporations, should play a leading role in the formulation of an integral policy for those sectors which produce and export commodities.

/C. Action

C. Action at the regional level

1. Regional co-operation in face of the crisis

Intra-regional co-operation, especially in the field of reciprocal trade, has taken on a very special meaning within the framework of the constraints now prevailing in the external sector and of the consequent need for a more inward-looking style of development than that which obtained during the 1970s. Actually, co-operation and integration are processes which can be very powerful in mitigating the negative effects of those constraints and reactivating the region's economic growth.

To these ends, it will be necessary first to share the task of developing idl productive capacity, so as to increase the degree to which it is utilized through complementary measures. Secondly, the pressing need to step up efficiency in productive activities makes it advisable to take maximum advantage of economies of scale, which can be more easily done in an expanded market. Thirdly, an increase in intra-regional trade will reduce the use of foreign currency per production unit.

In other words, by sharing the markets, the Latin American countries would achieve a higher degree of collective economic security and would further the possibility of basing growth to a steadily increasing extent on regional demand and production. Moreover, as has already been stated, the narrow room for manoeuvre in face of international economic trends that is available to the majority of the countries of the region -especially those of smaller size- would broaden considerably if joint, or at least better co-ordinated, action were taken vis-a-vis third countries.

This does not mean, however, that the regional integration and co-operation processes must necessarily take the same forms and be directed at the same goals as when they were first embarked upon in the region over twenty years ago, and in entirely different circumstances.

It would of course be unrealistic to aim at a goal which the processes now in motion were unable to achieve during the two preceding decades -the formation of a Latin American common market. The logical approach would be to start with the existing arrangements, which are based primarily on subregional groupings, while at the same time striving to bring them into closer convergence with one another. It would also be useful to promote the development and diversification of the partial integration and co-operation measures which enjoyed considerable success during the past decade and have made a powerful contribution to the progressive interlinking of the region's economies.

A first step in this direction would be to revitalize the Latin American Integration Association (ALADI), thereby infusing greater dynamism into the integration organization that has the widest geographical and economic coverage in the region, and also to invigorate the integration arrangements currently in operation in the Andean Group, Central America and the Caribbean. Use could also be made of the Montevideo Treaty of 1980, which envisages the possibility of promoting joint action on the part of the member countries of ALADI and other subregional integration groupings, in order to strengthen the convergence of

/the integration

the integration movements existing within Latin America or to bring them into closer relation with groupings belonging to other developing regions. Advantage could also be taken of the opportunities offered by the same Treaty to promote partial integration measures in order to spur and systematize the various forms of co-operation in specific domains which are being developed in Latin America.

There are basically two potential sources of new impetus for the processes of regional integration and co-operation.

As has already been remarked their logical starting-point is to be found in the existing formal integration schemes, which for the most part are subregional in scope. To encourage and facilitate reciprocal trade flows, countries will have to grant preferences to products from their own groupings, whether they be tariff preferences or apply to non-tariff barriers affecting such trade. Something must also be done to strengthen the existing mechanisms for financing the payment of the Latin American countries' debit balances on intra-regional trade, so that as little foreign exchange as possible is used in these transactions, and to make more financing available for the production and export of the goods traded within the region.

However, regional co-operation has not been confined to the field of trade nor is there any reason why it should be. There are many examples of joint efforts in specific sectors, which are much more advantageous than the alternative of making only separate efforts in those same sectors. Nor must co-operation necessarily be circumscribed within the geographical area covered by the existing subregional groupings; as has been pointed out, there are mechanisms whereby these boundaries can be overstepped so as to establish links between the different groupings themselves or with countries which do not belong to any of them.

If these efforts are to prosper, it will be necessary to ensure that the countries of relatively smaller economic size obtain a sufficient share of the benefits of the corresponding co-operation activities, and to this end preferential machinery will have to be established on their behalf.

2. The expansion of intra-regional trade

As was indicated earlier, in the present circumstances, renewed priority has been accorded to the growth of intra-regional trade.

Although the appropriate ways of achieving this objective will vary from one subregional grouping to another, they will usually involve preferential tariffs, full utilization of the machinery for clearing payments, more export credit and at least some basic agreements as to trade practices. In other words, the first step in any effort to increase reciprocal trade must be to reduce the barriers which now obstruct it at the level of the existing subregional groupings and to adopt a set of provisions agreed upon in advance by the governments concerned.

An increase in intra-regional trade can be brought about only if it actually proves beneficial, i.e., if the goods traded are reasonably competitive with goods from third countries. It will therefore not occur unless the countries

/adopt such

adopt such policies and mechanisms as will allow their reciprocal trade to offer real advantages to all parties, within the framework of the existing legal commitments. In other words, it is not enough for trade to increase as a result of spontaneous forces or mere geographical proximity. Intra-regional trade is susceptible of rapid expansion only in so far as governments adopt deliberate measures with that end in view.

Important instruments for sustaining the present level of trade within the region and supporting its future growth include, inter alia, machinery for the lifting of tariffs. In this connection, the early entry into force of a significant regional system of preferential tariffs in the framework of ALADI would result in better use of the member countries' installed production capacity and in the complementarity and specialization of their economies, Likewise, such a preferential system could be a useful instrument for initiating a process of convergence with other integration schemes in Latin America and the Caribbean.

However, in order to divert towards the region some of the trade flows which are meeting with insufficient demand in the industrialized centres and to create other flows, the countries of the region should also seek different operational modalities to supplement the preferential tariffs granted at global level or under each integration arrangement. Among these forms of action, bilateral or multilateral compensated trade agreements for specific sectors or products have grown in importance, and so has the use of the combined purchasing power of ff State enterprises. In the latter connection, attention should be drawn to the initiative taken by the petroleum companies of Brazil, Mexico and Venezuela in setting up a joint enterprise for purchasing inputs and marketing (PETROLATIN). Both types of action, in addition to establishing mechanisms for the provision of detailed and up-to-date information on trade flows and markets, should help to channel trade towards the region.

Similarly, it is of priority importance and feasible in the short term to strengthen and interconnect the multilateral payments machinery (Central American Clearing House, Multilateral Payments Clearing System of the Caribbean, and the Reciprocal Credits and Balances Clearing System of ALADI); the balance-of-trade and balance-of-payments machinery (Santo Domingo Agreements, Central American Monetary Stabilization Fund and Fund for Financing Debit Balances in the Central American Clearing House) and the export credit financing and insurance machinery (BLADEX, SAFICO and ALASECE). In general, the majority of these initiatives have already been studied and could increase their contribution to reciprocal trade and to the saving of foreign currency in the region.

The Inter-American Development Bank has played a very significant role in the development of Latin America in its nearly twentyfive years of existence, ee uniting the resources of the countries in the region with resources from countries outside the region. Reference has already been made, in general terms, to its needs for additional resources. However, the Bank would acquire growing importance in the process of Latin American integration if it did more to promote the financing of intra-Latin American exports and if it constantly expanded its action in favour of regional co-operation, including measures in respect of the promotion and financing of investment projects with an integrationist content.

/Mention should

Mention should also be made of the possibility that private and public banks in the region may be able to take joint action in the big international financial centres both to increase their capital base and to penetrate these markets more effectively, while at the same time reducing the risks of their transactions. The Andean Reserve Fund currently in operation is a good starting-point for the implementation of these suggestions.

From this short review it can be seen that Latin America has institutions in the financial field which cover most of the possible areas of action. Rather than creating new institutions, it seems advisable to strengthen those already in existence, expanding their capacity for attracting external resources. It is also worth while to incorporate some additional instruments, such as, for example, a special unit of account to facilitate payments and save external resources in intra-regional goods and services transactions. Proposals to further this end have already been made for Central America and the Andean Group.

As was said before, it does not seem possible to make progress in Latin American economic co-operation on lines compatible with attainment of the objectives of accelerated, autonomous and equitable development for all the countries of the region without giving special attention to the relatively less developed countries, either within each integration scheme or by seeking ad hoc instruments whereby a link could be established between them and the non-aligned countries. To a large extent the legal framework for such an arrangement already exists, in that the eee Montevideo Treaty of 1980 makes it possible to offer non-reciprocal preferential treatment to developing countries which are not members of ALADI, such as the Central American and Caribbean countries, and to others which, like Panama, the Dominican Republic and Haiti, are not members of any integration scheme. The region will not attain its true political and economic importance until there is a network of effective links uniting all the countries of the Latin American community, while at the same time avoiding the introduction of certain factors which tend to create rather inequitable relationships among them.

Moreover, the more highly developed countries of the region can make a big contribution to the common task of generating new opportunities and options for those countries which are less developed.

3. Co-operation in specific sectors

It is important to lay stress on the dynamism shown in the past decade by co-operation between two or more Latin American countries in activities in specific fields, carried out in conjuction with programmes promoted by the subregional integration schemes. There are many significant experiences and possibilities in this respect, covering a wide range of sectors.

In the case of transport, for example, experiments already tried out show that measures can be applied to improve the management and technology of movements of goods involved in the Latin American countries' foreign trade, both intra-regional and with the rest of the world. It is primarily a matter of lowering the cost of these transactions, making them more competitive with the services offered by third countries, and attracting an increasing share of the big freight and insurance market which today is largely in the hands of firms from outside the region. It should be noted that in 1982 the region made external payments for freight amounting to about US$ 12 billion.

/Moreover, the

Moreover, the crisis through which Latin America is passing has exposed the great shortfalls and imbalances in the productive systems of most Latin American countries, and their extreme vulnerability to external events. One of the areas in which this vulnerability makes its most dramatic appearance is that of regional supplies of basic foodstuffs. The importance of increasing these supplies is shown by the fact that regional food imports soared from US$ 2 billion to US$ 14 billion between 1970 and 1982. Behind this figure lie the food needs of 55 million undernourished people whose indispensable incorporation into a normal bracket of consumption would still further increase the already immense expenditure of external resources in this sector. It is therefore necessary to give higher priority to meeting this great challenge. In this connection, support should be given to the Action Committee on Regional Food Security created at the most recent meeting of the Latin American Council, within the framework of the Latin American Economic System (SELA). With a view to coping with this situation, a number of Latin American countries have established national food security systems. Efforts are also being made by groups of countries, regarding which attention should be drawn to the Regional Food Plan of the Caribbean Community, a scheme which comprises specific multinational development projects, in addition to initiatives for the joint provision of agricultural inputs. However, these measures are not enough in face of the magnitude of the problem confronting the region, and particularly many of its individual countries.

In addition, in the highly important field of energy, 1981 marked the adoption of the Latin American Energy Co-operation Programme (PLACE), based on the recognition that the Latin American countries can overcome their big problems only by relying more and more on their own efforts and on the intensification of regional co-operation. The Plan of Action devised within PLACE establishes a number of short and medium-term objectives, among the most important of which are the following: i) increased integration of production, use of energy and economic development; ii) expansion and diversification of the energy supply and of regional capacity in science and technology; and iii) rationalization of the production and consumption of energy. The position of Latin America as an area with net surpluses of commercial energy but at the same time dependent on supplies from outside the region makes it economically possible to progress towards the formation of a stable and equitable regional energy market, which would move gradually towards self-reliance in energy.

One of the limitations of Latin American industrialization has been, of course the comparative lag in the production of intermediate inputs and capital goods. The existence of a market larger than the individual market found in each Latin American country could provide a support for fuller, more thoroughgoing and more self-sustaining industrialization. In the case of capital goods, co-operation measures could be directed, on the one hand, towards obtaining better terms for external supplies by bringing to bear the magnitude of the regional demand through

/joint purchasing

joint purchasing programmes -for example, in both the petroleum and the electric energy branches of the energy sector-, and on the other, could aim at partially reorienting part of that demand towards the region itself. The latter objective would fit in with the intention to raise the level of activity of the metalworking industry and related industries and services, to save on external financial resources, and to gain a certain amount of technological independence in deciding which types of capital goods are best suited to the conditions prevailing in our countries.

One of the greatest obstacles to these co-operation initiatives is undoubtedly the fact that the region's own sources of financing find it difficult to provide long-term loans for the purchase of capital goods of national and Latin American origin. The strengthening of the subregional and regional development financing institutions identified above is one way in which the gap in Latin American industrialization could be filled.

Chapter III

THE CHALLENGES OF THE CRISIS AND NATIONAL ECONOMIC POLICIES

A. The dilemmas of short-term policy

If whatever measures are adopted by the Latin American countries, individually or collectively, on the external front are to bear fruit, and if the present critical situation is not shortly to recur, it is indispensable that concurrently these countries proceed towards a style of development that is more equitable and more consonant with the new external circumstances. This task represents a formidable challenge to economic policy. As has been seen, in many countries of the region the present economic situation is characterized by the simultaneous existence of a low economic growth rate or even a decline in global production, high rates of unemployment and underemployment, galloping inflation, acute balance-of-payments problems and severe external indebtedness crises.

Naturally, these adverse macroeconomic circumstances have had a very unfavourable impact on the work of the main economic agents. Thus, in so far as the crisis has lengthened out and demand has failed to recover or has continued to fall, the financial problems with which many entrepreneurial sectors are beset have grown worse. As a result, their central concern has gradually moved away from the problems of production towards the struggle to obtain public resources to ensure their survival. In this context, the State has been subjected to many pressing demands and on more than a few occasions has had to allocate its resources on the basis of criteria reflecting the economic power or political influence of the applicants rather than a long-term view of the development process.

In addition, the radius within which economic policy manoeuvres has been reduced by the peculiar combination of prevailing macroeconomic circumstances. Actually, many of the measures which could be adopted to reactivate production and combat unemployment would, in the short term, tend to aggravate the problems of the external sector and also to speed up inflation. Conversely, not a few of the policies which could help to reduce the rate of increase of domestic prices and the balance-of-payments deficit would have negative effects on economic activity, employment and salaries and wages.

The complexity of the tasks now confronting economic policy is likewise enhanced by the inevitability of the adjustment which the majority of the economies of the region will have to make in order to adapt their operation to the constraints imposed by a very unfavourable external situation and by the significant costs which this process usually generates at first.

In actual fact, looked at in this perspective, the central objectives of economic policy in the immediate future should be to reduce the global cost of the adjustment as much as possible, see that the burdens it imposes do not fall exclusively on the countries of the region but also on their external creditors and finally to ensure that the inevitable domestic sacrifices have the least possible impact on the poorest and most defenceless groups in the society.

/To reach

To reach those objectives, and also to continue gradually but firmly establishing the bases for a new pattern of development which various domestic and external factors make imperative, economic policy and internal effort must play a fundamental role.

B. The external factors of adjustment

However, the magnitude of the social cost which in the last analysis the adjustment process implies will also be crucially dependent on the trends followed in the immediate future by the industrialized economies and world trade, and on the results achieved in the renegotiation of the external debt in which many Latin American countries are now engaged.

Actually, if the symptoms of recovery which have begun to appear recently in the United States economy were consolidated and strengthened, and above all if that recovery were accompanied by the reactivation of the other industrialized economies, the prospects for world trade and international commodity prices would be brighter. This in turn would facilitate the growth of Latin America's exports and the improvement of its terms of trade and would mean that at least part of the reduction in the external imbalance would be achieved by mechanisms which would tend to expand rather than to inhibit economic activity and employment.

If, on the other hand, the reactivation of the central economies turned out to be feeble, partial or of short duration, and world trade were therefore to remain relatively stagnant, the countries of the region would encounter much greater difficulties in increasing their exports and as a consequence the burden of adjustment of the trade balance would fall almost exclusively on imports. In such an event, since the volume of imports had already drastically contracted in 1982 and has continued declining throughout 1983, the attenuation of the trade imbalance would be accompanied by another substantial drop in the domestic product. In other words, the internal counterpart of the external adjustment would be recession and unemployment.

However, the cost of the adjustment process will also be decisively affected by the proceedings and outcome of the negotiations under way to reschedule the payments on the region's external debt.

These negotiations must rest on two basic premises. The first is that the losses derived from the mistakes in appraisal committed in initiatives and business affairs in which the Latin American countries and the international commercial banks both took part are the responsibility of the former as well as of the latter and must therefore be shared by both parties.

The second premise is that it would be counterproductive to require the Latin American countries to service their external debt fully and punctually during a period in which real interest rates have climbed to their highest levels in nearly half a century, in which the terms of trade of many of the region's economies have fallen to a level comparable only with that reached during the worst years of the Great Depression, and in which the combined effects of the international recession and the resurgence of protectionism in the central countries have called a halt to the growth of the volume of Latin American exports.

/If the

If the creditor banks and the authorities of the international financial institutions and the main industrialized nations fully understand these basic truths and consequently agree to refinance not only the amortization payments but also most of the interest on the debt, so that these payments can be made in a period when world trade has recovered at least some of its former dynamism, when real interest rates have fallen to levels closer to those current in the past, and the internal rectification policies initiated by the countries of the region have begun to produce their full effects, the process of adjustment will be economically less costly and politically more viable.

On the other hand, if the creditor banks and the international financial institutions do not act with the necessary flexibility and insist that an appreciable proportion of the interest payments due in 1983 and in the next two years be financed out of trade surpluses, the economic cost of the adjustment will not only be much higher but could in fact be politically and socially insupportable.

Indeed, because of the adverse conditions prevailing in international trade and also because a considerable number of debtor countries would simultaneously have to produce large external trade surpluses, this insistence would prolong and accentuate the internal economic contraction they are now undergoing.

In these circumstances, the already serious occupational and distribution problems would also tend to be intensified. Hence the option of a unilateral moratorium on external debt servicing, would be politically more attractive, since that would make it possible to go a long way towards disassociating the policy of internal reactivation from the constraints now imposed by the very small capacity to import.

Naturally, such an option would have grave consequences not only for the stability of the international financial system and even for that of some of the largest banks in the leading industrialized economies, but also for the evolution of the world economy as a whole.

C. The need for a new style of development

However, even if trends in international trade improved and the region gained access in the immediate future to external financing which enabled it gradually to reduce the external imbalance, the process of readjustment would require enormous internal efforts and radical changes in national economic policies.

This seems particularly obvious in view of the fact that to carry out over the next two years an adjustment process which would make it possible to balance the countries' external accounts and at least to hold to the *per capita* product levels already achieved is only the most immediate and urgent challenge with which economic policy is faced. In the medium term, it will have to try to meet another no less complex and inescapable challenge, which is that of gradually, but persistently and steadily changing the development style which has so far prevailed in most of the countries of the region.

/It is

It is obvious that in the future the countries of Latin America will be able to achieve neither rapid and sustained growth nor an equitable distribution of the fruits and opportunities it affords if they return to the pre-crisis pattern of development.

This is partly because the external situation they will have to deal with will be less favourable than in the past. In the first place, in contradistinction to what happened in the 1970s, Latin America will not have easy access to an abundant flow of net external financing, since that financing will be restricted not only by the substantial amount of the accumulated external debt but also by the contraction in available international resources due to the drop in the financial surpluses of the petroleum countries and to the austerity policies which are part and parcel of the adjustment process in the industrialized economies. Secondly, and in spite of the signs of recovery recently shown by the economy of the United States, the prospects for early reactivation and in particular, for the initiation of a period of high and sustained growth in the industrialized countries as a whole are still very uncertain, which makes the chances for the expansion of international trade look dim. Finally, the possibility cannot be ruled out that the recent recession may have marked a turning-point in the lengthy process of expansion begun by the industrialized countries after the war, and that therefore the trasition to a new pattern of development -whose main features are yet to be defined- might be even more long-drawn-out.

However, the need for thoroughgoing changes in the predominant mode of development also derives from internal factors. Some of the structural problems which have traditionally affected the development of many countries of the region (such as the persistence of high rates of unemployment and underemployment and a marked unevenness in the distribution of income and opportunities) have grown very much worse in recent years as a result of the decline in the rate of economic growth and the measures adopted to control inflation and to balance external payments. Partly on this account and partly because in what remains of this decade the economic dynamism of Latin America will be less marked than that achieved in the period preceding the crisis, it will not be possible to attenuate these central problems significantly unless radical changes are introduced in the prevailing style of development.

Of course the specific characteristics of those changes, as well as the main features and relative importance of the domestic policies designed for bringing them to pass, will have to be different in the different Latin American countries, since these differ in their levels of development, their economic, social and political structures, their external linkages and the nature and intensity of their basic socio-economic problems.

/D. Basic

D. Basic requisites of development strategy

Nevertheless, it seems obvious that both to overcome the conjunctural adjustment problems successfully and to make the structural changes directed towards altering the historical pattern of development, economic policies will have to be more austere, more efficient and, above all, more equitable than in the past.

1. Sobriety

The need for introducing a considerable degree of sobriety or austerity into economic policy is basically justified by three things. First and foremost, a distinction must be drawn here between the type of sobriety or austerity which is advocated primarily for the purpose of correcting inflation at the expense of the majority sectors of society, and the kind which should accompany a reactivation policy. In the latter case, limits must be set to consumption with the object of increasing saving and employment, without this necessarily implying a contraction in global consumption but rather a change in its composition, together with greater selectivity in imports. Besides being necessary for short-term progress in the struggle against inflation and in the re-establishment of external equilibrium, a considerable dose of sobriety is indispensable for raising the coefficient of investment and increasing the share of domestic saving in the financing of capital formation.

While the first of the changes in question will be essential for re-starting the growth of production following the prolonged stagnation in economic activity during the three-year period 1981-1983, the second is imperative since, as observed before, Latin America will not in the future be able to rely on the plentiful external financing that was available to it in the period preceding the crisis. Capital accumulation will therefore depend much more on the mobilization of domestic resources and less on the tapping of saving from abroad. This change will also be indispensable in ensuring that the general operation of the economy does not remain excessively dependent on external financing, whose amount and cost, as recent experience has dramatically shown, can be subject to abrupt fluctuations due to causes which are beyond the control of the national economic authorities. Thus, a rise in domestic saving, in addition to being crucial for accelerating the rate of economic growth, will be vital for strengthening the autonomy of the development process.

Of course, this change will mean that domestic consumption must increase at a rate lower than the growth rate of total production. Consequently, during a relatively long lapse of time it will not be possible fully to satisfy aspirations for a rapid rise in the material level of living.

This sacrifice will, however, have to be made primarily by those social sectors which enjoy relatively greater economic well-being and whose excessively abundant and diversified consumption has in many cases done much to weaken the process of capital formation and accentuate balance-of-payments problems. In contrast, for basic considerations of equity, Latin America's poorest population groups, whose income is at present not enough to cover adequately even the most basic consumer needs, must be exempted from any share in the sacrifice.

/The burden

The burden of the effort aimed at stepping up domestic saving must not be borne by the lower income groups but will rather require greater sobriety on the part of the higher income strata and the governments themselves. For this reason, and also because of the imperative need to reduce the public-sector deficit, which in many countries constitutes one of the main causes of inflation, it will be necessary not only to increase tax revenue and the income and efficiency of State enterprises, but also to reduce the absolute level in some cases and in others the growth rate of public expenditure. These cutbacks should be made, however, on the basis of strict selectivity criteria which take into account the contribution made by the various items of government expenditure to the satisfaction of the basic needs of the most deprived sectors, to employment, to external-sector equilibrium and to the growth process. Accordingly, the reduction in public expenditure will have to be concentrated in such fields as, for example, defence programmes, which do not make a major contribution either to the well-being of the poorest groups or to the increase in production capacity, and which in addition often have a high import content.

2. Efficiency

Nevertheless, austerity will not be enough. In view of the more restrictive external conditions on which the development of the economies of the region will depend, and the marked aggravation of a number of structural problems which have brought about the present crisis, it will be indispensable to lay much greater stress on efficiency. In the immediate future, in particular, it will be necessary, to learn to do more with less, since the margins of ease which were available prior to the crisis have now vanished or shrunk markedly.

In the short-run, the first requirement for stepping up efficiency is the maintenance or increase of the levels of employment of the labour force and the use of the existing production capacity. From a global economic viewpoint, nothing can be more inefficient than the simultaneous maintenance of appreciable idle or underutilized portions of the labour force and of installed capacity. Nor could anything be more damaging to the possibilities of future economic growth than to dismantle factories and productive facilities, as has been happening in some countries of the region. To do so means, in essence, the destruction of wealth accumulated at the cost of great sacrifice in the past, with negative effects on the capacity of the economy to expand; and the simultaneous disbanding of the managerial and technical personnel who directed those units of production and the skilled labourers who worked in them makes the situation that much worse.

The efficiency imperative also requires that the greater saving achieved by virtue of austerity policies be properly channelled into activities of top economic and social priority. Although in this respect the diversity of national problems and circumstances does not allow of generalizations valid for the entire region, it is obvious that in order to surmount the difficult balance-of-payments and external indebtedness situation faced by the great majority of the Latin American countries, it will be necessary to provide special incentives for the production of exportable goods and for import substitution, with due regard, in connection with the latter process, not only to the opportunities offered by the development of each country but also, and above all, to those of subregional and regional scope.

/Thus, together

Thus, together with the increase in economic activity and employment, foreign currency would become more readily available and it would be possible to regularize the servicing of the external debt while at the same time satisfying the greater demand for imports which would be generated as domestic production and income increased.

Moreover, for the twofold purpose of promoting better income distribution and more equality of opportunities and strengthening the flexibility and adaptability of the economic system, more resources will have to be earmarked for programmes relating to education, health and nutrition and for the enlargement, adaptation and dissemination of scientific and technological know-how.

Finally, in view of the urgent need to reduce the very high levels of unemployment and underemployment and to relieve the pressure on the balance of payments, encouragement will also have to be given to the expansion of those activities which use proportionally more manpower and whose requirements of imported inputs are relatively less. For these reasons it will be necessary to lend special support to agricultural activities, whose expansion would, moreover, help to solve some of the more serious problems of distribution in most of the countries.

3. Equity

In addition to imposing greater austerity and bringing about a more efficient use and allocation of resources, economic policy must promote a much more equitable distribution of the fruits of economic growth and greater equality in the access of the various social groups to opportunities for progress and betterment.

One of the most stubborn structural problems in the development of Latin America has been the notable inequality in the distribution of income and wealth. Some of its worst effects on equality of opportunities have been partially mitigated by the considerable progress made over the past thirty years by the great majority of Latin American countries in the fields of health and, in particular, education. However, the persistence of very inequitable structures of distribution is certainly the main shortcoming of the developing style predominant in the region.

Hence the systematic attenuation of the inequality of income distribution and, more particularly, the elimination of extreme poverty must be essential objectives in the new development strategies. This becomes particularly evident, moreover, when viewed in the light of two fundamental facts:

The first of these is that at present, thanks primarily to the persistently high economic growth rate achieved by Latin America between 1950 and 1980, the eradication of extreme poverty is not only ethically desirable but also economically feasible in many countries of the region. In other words, in the more advanced Latin American economies at least, poverty today is not caused first and foremost by the limitation of available resources but is rather due to the predominance of structures and policies which are responsible for the very unequal distribution of fruits of economic progress among the different social sectors.

/The second

The second fact is that, for reasons mentioned above which have to do basically with the more unfavourable external environment and with the accentuation of the structural problems which have caused the crisis, the economic growth of Latin America in what remains of this decade will be much slower than in past decades. If in these circumstances the traditional patterns of distribution were maintained, the absolute increase in the income of the poorest groups would be minimal and consequently the possibilities of their perceptibly increasing the degree to which their most basic consumer needs are met would also be practically nil.*/ Therefore, in order to make significant progress in the fundamental task of reducing critical poverty, it will be even more necessary than in the past to expend deliberate and systematic effort on changing the mechanisms which govern the social distribution of income.

To this end, however, it will be essential to pay much more attention to the selection of the policies and instruments to be used. Precisely because economic growth will be slower in this decade, and also because the countries of the region will have to make a much greater domestic saving effort, the task of redistribution will call for the use of those mechanisms which actually do channel the resources allocated to the struggle against critical poverty exclusively or at least primarily to the most needy groups and are of significant and lasting help in increasing the ability of those groups to meet their basic needs. In other words, in addition to having higher priority attached to it, redistribution policy must be more efficient.

E. Social consensus and participation

As has been shown, the complexity of the crisis through which the countries of Latin America are now passing and the less favourable external conditions which will condition the development of the region in the 1980s lay very stringent demands on economic policy. In particular, in order to control and reduce the grave inflationary and balance-of-payments disequilibria typical of the present economic situation and to put the process of economic growth back into motion, while at the same time laying the foundations for a gradual change in the prevailing development style, there will be a need for much more careful co-ordination of the various economic policies, fuller use and more efficient allocation of the resources available, and more efficacious management of production units.

However, albeit indispensable and a basic necessity, this increase in overall economic rationality will not be enough. Successfully to counter the challenge facing the region it will also be necessary to meet some conditions of

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*/ In this connection, it is useful to bear in mind that according to preliminary estimates made by ECLA during the period of rapid economic growth between 1960 and 1975, the average income of the poorest 40% of households in seven Latin American countries whose population represents somewhat more than 80% of the region's total population rose by barely US$ 250 (at 1980 prices), i.e., by less than US$ 17 a year. (The countries in question are Argentina, Brazil, Chile, Colombia, Mexico, Peru and Venezuela.)

/a political

a political and institutional type. Although by their very nature these conditions are difficult to generalize about at the regional level, there are at least three requirements of this kind whose validity is relatively extensive.

The first and most immediate of these is the obvious necessity to give public opinion and the various social groups awareness and understanding of the exceptional magnitude and the unprecedented complexity of the present crisis, its consequences and implications and above all, the types of solutions and sacrifices which will be required in order to surmount it. If this basic task of clarification is not properly performed, there will be a risk of widening the internal rifts between the social groups and between them and the governments, and thereby magnifying the intrinsically formidable difficulties involved in the handling of the crisis.

A second basic political-institutional requirement is that of improving the economic performance of the State, through realistic consideration and pragmatic utilization of the various alternative mechanisms available for the allocation of resources. Both for coping with the immediate demands of the present economic situation and for undertaking the no less difficult task of introducing substantial changes in the historical pattern of development, there will be need for firm and well thought-out guidance of the economic process. And that in turn means that the State must play an active role.

However, it is clear from Latin America's varied political experience that there are no mechanisms or intitutions which in and of themselves can ensure that the economic process is efficiently and legitimately conducted. In actual fact, there have been swings of the pendulum in the region's ideas as a result of which the State or the market, the democratic or the authoritarian institutions, have been presented either as the deus ex machina which can solve everything by its mere existence, or as the entity responsible for all political and economic problems.

Thus, the depression in the 1930s produced widespread pessimism concerning market mechanisms and eventually resulted in political-institutional arrangements in which the State and planning were called upon to play decisive roles. Decades later, the crisis in the latter renewed the gloss on the virtues of the former, and they again have been profoundly affected by the present disequilibria.

In the same way, the confidence which existed some decades ago in the mutually fruitful relationship between economic development and democratic régimes was undermined by the difficulties that those régimes encountered, making way for the rediscovery of the supposed merits of social discipline and authoritarianism, which in time also began to show their limitations and are now once again threatened by the trusting growth of democratic ideals.

Similarly, the recent significant reappraisal of the role of the market in several countries of the region was based on the confident belief that its free operation would provide better guidance for the most important economic decisions since, in addition to its supposed efficiency in the allocation of resources, a free market would have the virtue of impersonal objectivity. However, the nature

/and intensity

and intensity of the economic crises suffered by the countries that have followed this course have thrown light on the true nature of the market, i.e., that as a mechanism for the allocation of resources it is at the mercy of the prevailing economic structure and of pattern income distribution. Hence the market economy cannot by itself steer the development process, since this latter has economic, social and political objectives which must be deliberately pursued.

These limitations of the market make it indispensable for the State to play a decisive role in the conduct of the economic process, especially in periods of crisis. It would be a mistake, however, to fall into the technocratic illusion that State intervention alone guarantees a reasonable degree of efficiency and legitimacy, since in the domain of the economy it can be quite as inefficient and as inequitable as giving free rein to the governance of market laws.

Therefore, in order to achieve a higher degree of efficiency and legitimacy, many Latin American States will have to improve their performance in terms of co-ordination and consensus.

Co-ordination refers primarily to the need for the State apparatus as a whole -central and regional, fiscal and decentralized- to act in an integrated and harmonious fashion. The importance of improving the co-ordination of the activities and decisions of the various components of the public sector becomes particularly clear when it is recalled that in some countries of the region the effects of the present recession have been aggravated by the inconsistent way in which the State apparatus has acted. The achievement of consensus, for its part, has to do in particular with the ability of the State apparatus to reflect the interests of the social groups, orient their action and unite wills around common causes. If the co-ordination of the State apparatus is the necessary and primary determinant of State efficiency, consensus lies at the centre of the legitimacy of the State in pluralist mixed-economy societies, such as are most of those of Latin America. Together, these two attributes make up the essence of planning.

However, consensus is impossible without institutional machinery to permit and guarantee the participation of the social groups in important State decisions. That such mechanisms should exist and be operative is therefore a third basic political requirement. To restrain the authoritarian and technocratic tendencies which often germinate in those who control the State apparatus, it is necessary to consolidate democratic institutions, since only they can prevent State intervention from being primarily an expression of the influence of power groups, whether civil or military, public or private. However, as has already been pointed out, the strengthening of democracy or the return to it does not necessarily guarantee that a sufficient degree of efficiency in State action will be attained. In fact, the opposite often happens, since all social groups have a tendency to view the reinforcement or reinstatement of democracy as an apt occasion for the satisfaction of their own unmet demands.

In brief, to overcome the problems which accompany the unprecedented recession now besetting the countries of the region and to change the historical pattern of development with a view to increasing the autonomy and equity of the growth process, it is necessary to take supremely important decisions which will work profound changes in the economy and the society of the Latin American countries. Those decisions in turn call for States capable of implementing them,

/and this

and this means not only maximizing the efficiency of the State's performance but also, and primarily, securing a social consensus to afford it political support. Without such support, States will largely be the instrument of sectoral interests and will be unable to accomplish the task of meeting the historic challenge of today. And it is important to understand that in societies like those of Latin America, where democratic ideals have penetrated deeply, such a social consensus will not be achieved by coercive means but will rather reflect a free and responsible assent on the part of the governed. In turn, that assent will be given only if those who are governed participate fully in decision-taking and if they arrive at a deep inner conviction that the sacrifices they have to bear are inevitable, and above all that they are equitably distributed among all alike.

F. Final considerations

It has already been said that the present recession represents a pressing and formidable challenge to the Latin American countries, which calls for immediate and concerted action on the external front and for the adoption of domestic measures designed to adapt national development policies to a more restrictive international context.

As was stated in the introduction, and in view of the occasion for which this document was prepared, its analysis and recommendations are focused first and foremost on the present critical conjuncture and on the short-term measures which should be adopted in order to deal effectively with the situation. Attention has been more than once drawn, however, to the need to tie in the measures adopted to cope with the recession affecting the majority of Latin American economies with other measures designed to promote their reactivation. Emphasis has been placed on the need to base those policies on a greater degree of domestic effort, to stress to the utmost efficiency in the management of economic instruments and to ensure that greater equity is practised in the internal distribution not only of the cost of the adjustment but also of the fruits of the recovery which should follow it. It has also been said that if the countries of the region are to meet the crisis in tolerable economic and social conditions and, in particular, if they are to resume their sustained development, it is an essential requisite that the spirit of reactivation noted in the centres at the beginning of 1983 is maintained and diffused to the rest of the world economy.

The fact that, for reasons noted in several places above, this analysis is concentrated on the problems posed by the present conjuncture must not be interpreted as detracting from ECLA's concern for the need to introduce long-term structural changes into the Latin American countries' patterns of development and external insertion, profiting by the lessons learned from the recession, and with a view to meeting the unsatisfied needs of great majorities of their populations and coping with the profoundly altered external situation.

As the Executive Secretary said at the end of 1982 in his preliminary evaluation of the performance of the Latin American economy in that year, ECLA is convinced "that to surmount the present crisis, a new vision of the future will be required and a new system of international economic relations which will be responsive to the radical economic changes occurring in the world scenario, and which, besides making it possible to face the present emergency, will formulate new trade and monetary rules to facilitate the sustained growth of the world economy".