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OSCAR ALTIMIR  
*Director of the Review*

EUGENIO LAHERA  
*Technical Secretary*



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## CONTENTS

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<b>The interplay of macro- and microeconomics</b>	<b>7</b>
<i>Gert Rosenthal</i>	

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<b>Economic policy, institutions and productive development in Latin America</b>	<b>11</b>
<i>Oswaldo Rosales</i>	

---

<b>Systemic competitiveness: a new challenge for firms and for government</b>	<b>39</b>
<i>Klaus Esser, Wolfgang Hillebrand, Dirk Messner and Jörg Meyer-Stamer</i>	

---

<b>Education in basic skills and training for productive work</b>	<b>55</b>
<i>Guillermo Labarca</i>	

---

<b>Social investment funds in Latin America</b>	<b>73</b>
<i>Gabriel Siri</i>	

---

<b>Water rights markets: institutional elements</b>	<b>83</b>
<i>Miguel Solanes</i>	

---

<b>The Caribbean countries and the Free Trade Area of the Americas</b>	<b>97</b>
<i>Trevor Harker, Sidya Ould El-Hadj and Lucio Vinhas De Souza</i>	

---

<b>The Argentine experience: development or a succession of bubbles</b>	<b>111</b>
<i>Hugo Nochteff</i>	

---

<b>Potential and limits of health management reform in Chile</b>	<b>127</b>
<i>Ana Sojo</i>	

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<b>Guidelines for contributors to CEPAL Review</b>	<b>147</b>
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<b>Recent ECLAC publications</b>	<b>149</b>
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# Economic policy, *institutions and productive* development in *Latin America*

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**Osvaldo Rosales V.**

*Economic Affairs Officer  
Office of the Executive  
Secretary, ECLAC.*

ECLAC has submitted an overall assessment of the economic reforms implemented during the past 15 years to the Governments of the region and, based on that assessment, a proposal for strengthening the development process. The central message that emerges from this analysis is that the region needs to work towards forming closer linkages among its macroeconomy, microeconomy and institutional structure by reinforcing the complementarities between macroeconomic and microeconomic sources of competitiveness and fortifying the institutional framework for the development of production activity. Without jeopardizing existing macroeconomic sources of competitiveness—low and declining inflation, incentives for saving and investment, and a competitive exchange rate—the region needs to design microeconomic policies that will open the way for new sources of competitiveness: training and productivity, technological dissemination and innovation, investment abroad and infrastructure. To this end, a unified approach should be adopted which, while preserving a growth-oriented form of macroeconomic stability on the basis of a more determined savings and investment effort, will also foster a greater dissemination of technical progress and less heterogeneous gains in productivity than at present. This type of approach also appears to call for a better balance in terms of both institutions and resource allocation between macroeconomic policies and policies for promoting productive development. In addition, an effort must be made to refine the assessment capabilities and relevance of policy tools for productive development, to enhance the performance and decentralization of policy management in this area, and to reinforce these policies' linkages with growth and efficiency.

# I

## Economic changes: the overall picture

The 1980s were a watershed decade in terms of the behaviour of the Latin American and Caribbean economies. Although there were differences in sequencing, intensity and outcomes, all the countries experienced sweeping changes in the content of their economic policies and strategies as well as in their production systems themselves and their relationship with the global economy.

These reforms were triggered by the external debt crisis and were implemented as part of the monumental effort made by all the countries – each according to its individual possibilities and traits – to adapt their economies to newly emerging circumstances at home (the gradual obsolescence of one style of development) and abroad (technological change and economic globalization).

Although they are far from being alike, all these reform programmes have pursued the goals of macroeconomic stabilization and international competitiveness by means of fiscal discipline, trade and financial liberalization, a stronger emphasis on market mechanisms, greater reliance on private investment, and new incentive and regulatory systems. Where these economic strategies have differed has been in the intensity of the reforms, in the sequencing of those reforms and of stabilization policies, in the types of exchange policy tools employed (fixed exchange rates, crawling pegs, with or without currency bands), in the liberalization of the capital account (the extent of the process and the sequencing of financial and trade-related measures), in anti-inflation policy (how steep of a reduction, with or without indexation), in the extent of corrective government action (transfers and the targeting of government ex-

penditure) and, last but not least, in the share of GDP represented by public-sector expenditure and in the share of public-sector expenditure represented by social expenditure.

The combination of these similarities and individualities has brought about a fundamental change in the region's development process. The similarities provide us with grounds for talking about a turning point in strategy, while the individualities prevent us from summing up this process as a transition to a homogenous and generally-applicable "model".

One of the main features that differentiates the individual countries' experiences is the extent to which economic reforms have been accompanied by institutional changes. Examples include the autonomy of monetary authorities, a code of conduct for fiscal policy and for the management of State enterprises, the prudential supervision and regulation of the financial system and the degree to which privatization processes have been coupled with a reinforcement of institutions and tools for promoting competition, including the regulation of natural monopolies.

Within this same institutional framework, significant differences are also to be found in the countries' policies on productive development (with or without mechanisms for building a consensus among the relevant actors) and the specific attributes of their sectoral policies in terms of degree and content.

As a result of these processes, the countries of the region have made headway in both the macroeconomic and microeconomic spheres. In the macroeconomy, advances have been made in stabilizing prices and, to a lesser extent, in promoting growth. Contributing factors in this respect have included fiscal and monetary discipline and, since 1991, an abundant inflow of external capital; the existence of large differentials in rates of return has certainly been one of the reasons for these inflows, but another has been the confidence inspired by the countries' macroeconomic management and structural reforms and the progress they have made towards the establishment of democratic systems. Nonetheless, the region's

□ The ECLAC view on the issues discussed in this article is set forth in a key document, *Strengthening Development. The Interplay of Macro- and Microeconomics* (ECLAC, 1996a) the empirical support for which is contained in a companion volume entitled *The Economic Experience of the Last Fifteen years. Latin America and the Caribbean, 1980-1995* (ECLAC, 1996b). The reader is referred to these two publications for quantitative evidence and a more detailed analysis of each issue.

average growth rate for the 1990s has been no more than moderate: respectable but below its traditional level of performance and unsatisfactory from the dual standpoint of technical progress and the elimination of social lags.

The restructuring of production patterns which is now underway has not yet generated a sufficient rate of job creation or an acceptable reduction in inequalities; in fact, many countries' indicators of social equity have still not even regained their pre-crisis levels. The number of high-quality jobs has been very slow to rise, and the relative wage rates for jobs requiring different skill levels have tended to diverge further.

Compensatory social policies have so far been of limited effectiveness; social expenditure has been curbed by efforts to maintain budgetary discipline, and social policy management has not evolved or progressed to a sufficient degree.

The region's economies continue to work from a position of vulnerability. In most cases, macroeconomic stability has been achieved at the cost of large deficits on the balance-of-payments current account, and in some instances these deficits have been financed with volatile capital that may be withdrawn the moment that anything shakes investors' confidence.

Indeed, one of the hallmarks of the 1980s was a steep downturn in saving –and, in particular, investment– rates, although this decrease was sharper in some countries than in others. These coefficients have gradually been moving back up during the 1990s, but have still not reached their pre-crisis levels in the vast majority of the countries.

The structural reform and adjustment processes have acted as a powerful screening device which has forced each economic agent to adapt to the new conditions existing in relation to price signals and the regulation of production activity.

The production activities that have been hit the hardest by this change in the ground rules and the regulatory system have been branches of industry that serve the domestic market, which make fairly intensive use of local engineering services; small and medium-sized firms; and State-run enterprises as a group. In contrast, export sectors, natural resource-based activities, large locally-owned conglomerates and many transnational corporations have been more successful in adapting to these new circumstances.

A shift in production towards natural resource-intensive tradables, especially mining products, has been observed. Among non-tradables, the growth rates

for the energy, construction and transport sectors have been outpacing the expansion of GDP. In the Caribbean, the tourism sector, *maquila* industries and data-transmission services are particularly important areas of activity. The manufacturing sector is being restructured as it moves away from a pattern of specialization based on mechanical engineering and towards a pattern based on natural resource-intensive activities (aluminium, petrochemicals, paper and pulp, food products and non-ferrous metals). The expansion of these areas is balanced out by reductions in textiles, leather and footwear, capital goods and fine chemicals.

There have been promising signs of the absorption of technology in industries involved in developing and managing natural resources for production purposes (agriculture, forestry, fisheries and mining) and of the effects of modernization processes on financial services, telecommunications, energy and transport.

On the other hand, the structural heterogeneity which is characteristic of the region's production apparatus has been heightened as the productivity gap widens between the large companies at the forefront of the modernization drive and the broad range of activities that have fallen behind in this process.<sup>1</sup> This not only sets the scene for greater social inequality by increasing domestic productivity differentials and the production structure's degree of economic concentration, but also impairs the economy's growth potential by limiting the expansion of linkages and the spread of technical progress while also slowing the momentum of exports.

The economies of the region are quite clearly turning their attention to external markets, and this reorientation is firmly backed up by a more intensive development of natural resources. Indeed, the export coefficient has climbed from 14% of GDP in 1980 to 21% in 1990 and to 25% in 1995.

The region's economic buoyancy has been bolstered by trade agreements and the intensification of integration schemes that have sparked a substantial expansion of intraregional trade and investment, rising levels of competitiveness in a growing number of

<sup>1</sup> Productivity gains tend to be concentrated in and among modern manufacturing activities, export-oriented agriculture, large-scale mining enterprises, the energy sector, telecommunications and financial services.

production sectors and enterprises, and a notable increase in the ability of firms in the region to win over outside markets. Progress is also being made in the diversification of export activity and the application of technical advances (natural resource development, agricultural distribution chains, and natural resource-intensive industries).

Although, generally speaking, commodity trade is declining as a percentage of total exports, the growing significance of manufactures and semi-manufactures attests to a strong bias in favour of

natural resource-processing industries, and the share of external sales accounted for by commodities – foodstuffs, non-food farm products, metals and minerals, and fuels – remains above the average for developing countries. Moreover, commodity trade yields a surplus which helps to cover the manufacturing and services sectors' net deficit.

Given this situation, part of the region's export effort has been thwarted by the fact that its export structure is still highly concentrated in slow-growth products with weakening and erratic prices.

## II

### Institutional structure and changing production patterns

Overconfidence in the "automatic" effectiveness of macroeconomic signals and reforms has engendered a tendency to underestimate institutional weaknesses and the flaws to be found in the region's markets (which may be imperfect, segmented or incomplete, or may have been distorted by externalities) and to what is perhaps an over-reliance on the ability of macroeconomic policy alone to set in motion the dynamic of growth and the absorption of technical progress. As stabilization and structural adjustment efforts have tended to coalesce, the underlying structural causes of the region's macroeconomic instability have come to be recognized.

This recognition should prompt the Latin American and Caribbean countries to address their concerns as to the current operation and growth potential of their economies from a vantage point which integrates macroeconomic conditions, regulatory systems and institutions, the operation of factor markets and microeconomic behaviour. Consideration of these interactions leads to a fuller understanding of the practical difficulties involved in simultaneously achieving macroeconomic stability, rapid growth, satisfactory levels of employment, and sufficiently high rates of saving, investment and technical progress to ensure sustained development.

Virtually all the economies of the region suffer, to a greater or lesser extent, from structural and institutional problems which make it difficult to achieve a sustained increase in growth based on market signals

alone. On the one hand, existing natural resource-based activities and public services offer greater advantages in the short run in terms of both risk and profits than many promising activities that require the development of technological capabilities; on the other hand, the shortcomings of the region's capital market impede profitable longer-term investments and the deployment of innovations in production activities.

The existence of segmented or incomplete markets diminishes the range of opportunities for multiplying linkages within production systems as well as the spread of demand and technical progress from leading sectors to the rest of the economy. Furthermore, segmented or incomplete financial markets provide no assurance that savings will be channelled into investment.<sup>2</sup>

The structural failings of the region's financial markets hinder both investment and innovation. The segmentation of the credit market continues to have the effect of denying small and medium-sized enterprises access to mainstream resource flows. Large interest-rate spreads transform low real interest rates on deposits into onerously high real lending rates for

<sup>2</sup> In the early 1990s, the injection of large quantities of external resources into these types of markets fueled major booms in financial activity and in the region's stock exchanges which were reflected, to a large extent, in consumption and investment in non-tradables via predominantly short-term transactions.

production activities, while, in general, the region's financial systems continue to operate according to a rationale that stresses security over profitability.

The aims of productive development policies are to boost total factor productivity, to upgrade the quality of goods and services, and to promote efforts to generate and disseminate technological capabilities with the help of a series of measures designed to further the development and reinforcement of national systems of innovation. These systems need to foster an effective form of interaction among the various institutional actors concerned and should be based, to an increasing degree as time goes by, on private-sector resources. Means of strengthening such systems include support for information networks, reinforcement of the entrepreneurial base, protection of intellectual property rights, promotion of sectoral technological outreach and research centres, adoption of international quality standards and regulations, and skills development and training.

The network of public institutions involved in the design and implementation of development policies needs to keep pace with the internationalization of the region's economies. In particular, development policies and instruments need to be brought into line with commitments made in connection with multilateral agreements and integration schemes. Along similar lines, as part of the effort to promote exports, a higher priority needs to be placed on investment abroad and participation in marketing chains as well as on brand differentiation and quality.

The main message here is that the macroeconomy, microeconomy and institutional structure need to be more closely linked to one another so as to reinforce the complementarity of macroeconomic and microeconomic sources of competitiveness and to strengthen institutional mechanisms for promoting productive development.

### III

## An assessment of economic policy

### 1. The external credit crunch and adjustment

Since the time of the debt crisis, the situation as regards the external sector imbalance can be divided into two clearly differentiated periods in terms of the net direction of resource transfers and how this has influenced the region's economic performance. The first period, from 1982 to 1990, was a time of adjustment during which there was a negative net transfer of resources amounting to 3.2% of GDP; during the second, from 1991 to 1994, external savings fueled a recovery and the countries received net inflows equivalent to 1.5% of GDP.

During the period from 1982 to 1990, economic performance fell far behind the production frontier, with actual GDP being well below the region's potential GDP; this led to a serious underutilization of production resources and –in combination with the existing instability of the economy– to a steep drop in investment, which, in turn, limited the future expansion of output. All of this translated into slow growth, a decline in per capita GDP and virtually flat domestic demand up to 1990.

As a consequence of the international credit squeeze experienced during these years, balancing the current account became a top priority. Since the countries of the region had to set aside large sums of money for interest payments and profit remittances –thereby generating a deficit on the financial services account– they had to find some way of building up a large trade surplus, and in order to do so, they had to keep real exchange rates above their long-term levels. During the 1990s, once the external credit crunch had eased, this ceased to be the leading objective, and attention shifted to the need to finance the balance of payments, which entailed attracting enough capital to cover the growing deficit on current account. Except in a few cases, the authorities stopped using the real exchange rate as one of their main economic policy tools, and this rate thus came to be determined by the volume of capital flows.

At the start of the present decade, the negative transfer of financial resources seen between 1982 and 1990 reversed direction. The countries of the region regained access to private external finance and began to secure large quantities of such funds from a variety

of different sources, although lenders did display a stronger preference for short-term operations than in other developing regions.<sup>3</sup>

Foreign direct investment (FDI) and portfolio investment rose in response to bond and stock offerings made either directly or via ADRs and GDRs, while official financing and private debt both shrank. Net capital flows climbed to 5% of GDP in 1992-1994, thereby surpassing their previous all-time high (4.5% in 1977-1981). Although inflows were concentrated in Mexico, Argentina, Brazil, Chile and Peru, incoming capital amounted to over 5% of GDP in 11 countries of the region.

Between 1992 and 1994, as external financial constraints abated, a heavy net inflow of resources permitted the region to cover its mounting trade and current-account deficits, for the region's trade deficit reappeared, in 1992, with imports climbing at twice the pace of exports, and a deficit on current account of more than 5% of GDP was posted by nine countries (Bolivia, Costa Rica, Guatemala, Haiti, Honduras, Mexico, Nicaragua, Paraguay and Peru) although in most cases the income registered on the capital account was more than enough to cover the shortfall.

Between 1991 and 1994, capital inflows did away with the external financial constraints affecting the region and helped to galvanize production and domestic demand, which had a beneficial effect on employment and wages. The increase in investment prompted by the change in the macroeconomic climate was bolstered by the capital inflows which helped the region to finance its widening deficit on current account up to 1994. Furthermore, inflation slowed considerably, and the public sector posted either surpluses or small, manageable deficits. These conditions helped the region's economies to regain some of their growth potential within a context of greater stability and diminishing external constraints.

## 2. Unconsolidated stabilization

A comparison of the macroeconomic environments of the mid-1990s and the second half of the 1980s

reveals some major changes: a moderate increase in the level of activity, less of a tendency to run up public-sector deficits, a slower expansion of the money supply, an upsurge in investment levels and a reduction in unemployment.

Thanks to a more favourable international financial environment for suitable mixes of financing and adjustment, the reforms and improved quality of the countries' economic policies were reflected in a slowdown of inflation in most cases, particularly in Bolivia since the mid-1980s and, more recently, in Argentina, Brazil, Nicaragua and Peru. During the 1990s the number of countries with inflation rates near or below 10% has been increasing, in sharp contrast to the situation in earlier years (see table 1).

By permitting the value of the currency to rise in real terms, the increased volume of external finance has contributed to the stabilization effort in various countries. The use of "nominal anchors" is important in any stabilization process, but it is especially so if such a process is initiated following bouts of hyperinflation and capital flight; their contribution is all the greater, of course, if they form part of a policy package designed to bring about a lasting improvement in the fiscal situation and to buttress the financial system's solvency.

One of the important lessons learned from the debt crisis was that a sudden jump in the supply of external resources will usually trigger an unsustainable rise in consumption. To prevent this from happening, the bulk of available financial resources must be channelled into real investment in order to boost the economy's future payment capacity; otherwise, any stabilization will be short-lived.<sup>4</sup>

In order to achieve and maintain a low inflation rate over the long term in an economy undergoing trade and financial liberalization, its export sectors and industries producing tradable goods need to have attained a sufficient level of development, diversification and flexibility. The stability of incentives for these sectors plays an important role in consolidating an economy's stabilization and, as past experience has demonstrated, large real revaluations are there-

<sup>3</sup> Between 1990 and 1994, portfolio investment flows for developing countries as a whole represented 41% of total inflows of external resources, while 37% corresponded to foreign direct investment (FDI). For the region, however, portfolio flows amounted to 66% and FDI 30%. In contrast, in Asia a marked preference for long-term funds (45% in FDI) was evident, while only 24% of total resources corresponded to portfolio investment (IMF, 1995).

<sup>4</sup> One crucial factor for the success of a country's stabilization policies is the achievement of high, stable levels of investment. Inflation discourages investment and diminishes its efficiency, thereby limiting a country's growth potential. Thus, a successful stabilization effort ought to be reflected in higher growth and investment rates.



TABLE 1

**Latin America and the Caribbean: trends in selected  
macroeconomic variables, 1986-1990 and 1991-1994**

Trend	Public-sector deficit	Public-sector surplus	Growth of money supply (M1)	Gross fixed investment/GDP	Real exchange rate for exports	Real average remunerations	Urban unemployment
<i>Upward</i>							
1986-1990	-	1	8	5	7	3	7
1991-1994	4	2	4	8	4	11	3
<i>Downward</i>							
1986-1990	6	-	6	7	4	7	5
1991-1994	4	1	10	1	5	1	3
<i>Stable</i>							
1986-1990	-	-	-	1	-	3	1
1991-1994	3	1	1	8	6	3	9
<i>Variable</i>							
1986-1990	11	-	3	5	6	2	4
1991-1994	3	-	1	1	2	-	3

Source: ECLAC, on the basis of official figures.

fore inadvisable; ideally, such adjustments should be kept in line with productivity growth in the tradable goods sector.

### 3. A shaky fiscal adjustment

The financial crisis that overtook the public sectors of the vast majority of countries in the region was one of the most significant aspects of the economic disturbances experienced by Latin America and the Caribbean during the 1980s (ECLAC, 1993). In the 1990s, the situation—at least up to 1994—has been just the opposite, since almost all the economies have enjoyed a period of relative stability thanks to the progress made since 1991, particularly in terms of the fiscal adjustment processes begun in earlier years and the resumption of external financing. Although the situation varies from country to country, during the 1990s there has been a widespread trend towards a reduction of fiscal deficits.

The sweeping fiscal adjustment drives that were launched in the first half of the 1980s, when the debt crisis was at its height, enabled most of the countries to cut their fiscal deficits by between five and six points of GDP. Except in a few cases, however, these processes failed to yield satisfactory results because external conditions remained adverse.

The restoration of external credit, the resumption of growth and the price stability characteristic of the

Latin American economy in 1990-1994 helped to strengthen its fiscal performance. The possibility of obtaining voluntary financing in international markets opened up the field for domestic borrowing and reduced its cost. As a result of the appreciation of the countries' currencies, which was also associated with their capital inflows and the build-up of reserves, interest payments on the external debt came to represent a smaller portion of public budgets in real terms. Tax receipts' response to the acceleration of economic activity was quite elastic, and the slowing of inflation boosted real tax revenues (see table 2).

All these factors, together with the countries' structural reforms, helped to reshape the fiscal environment. In terms of their effects on public finances, an especially important role was played by changes in the tax system (a greater emphasis on excise taxes, the expansion of the tax base, the lowering of tax rates, reductions in customs duties and stricter enforcement of tax laws). In some cases, the sale of State-run enterprises and the expansion of programmes for the privatization of public utilities have had a decisive effect. The decentralization process was also carried forward, the civil service was downsized and efforts to privatize social security (medical and pension) systems were stepped up.

The after-effects of the debt crisis still weigh heavily on fiscal policy, especially since, in a number of cases, localized financial crises have escalated to

TABLE 2  
Latin America and the Caribbean (18 countries): public-sector balance at current prices<sup>a</sup>  
(As percentages of GDP)

Country	Level <sup>b</sup>	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994
Argentina	NNFPS WP	-5.5	-9.6	-10.6	-10.5	-8.3	-4.3	-3.3	-5.3	-8.2	-3.7	-3.8	-1.6	-0.1	-0.1	-0.4
Bolivia	NNFPS	-7.8	-7.6	-14.2	-17.9	-26.6	-10.9	-3.1	-7.3	-5.8	-4.8	-3.9	-3.7	-4.8	-5.8	-4.2
Brazil	CPS	-1.6	-3.2	-4.1	-4.1	-3.4	-4.2	-3.6	-5.7	-4.8	-6.9	1.2	-0.2	-2.8	-1.3	1.2
Chile	CG	6.5	2.8	-3.4	-2.6	-2.9	-3.8	-0.8	1.9	1.7	2.8	3.5	2.4	2.8	2.0	2.0
Colombia	NNFPS	-2.6	-5.3	-6.0	-7.6	-6.3	-4.0	-0.3	-1.9	-2.2	-1.9	-0.6	-	-0.2	0.3	2.6
Costa Rica	CG NNFPS	-8.1	-3.5	-2.6	-4.3	-3.1	-2.0	-3.4	-2.0	-2.5	-4.1	-4.4	-3.1	-1.9	-1.9	-7.0
Ecuador	NNFPS	-7.4	-8.5	-7.2	-5.2	-1.2	0.2	-3.7	-9.6	-5.3	-1.6	0.6	-1.0	-1.7	-0.4	-0.2
El Salvador	CG	-5.3	-6.6	-7.0	-8.8	-5.8	-3.8	-2.8	-3.8	-3.2	-4.9	-3.6	-5.2	-5.2	-3.3	-2.1
Guatemala	CG	-4.7	-7.4	-4.7	-3.3	-3.8	-1.8	-1.9	-2.4	-2.4	-3.8	-2.3	-0.1	-0.5	-1.5	-1.5
Honduras	CG	-8.7	-8.1	-13.0	-10.9	-12.3	-9.8	-8.7	-8.1	-6.9	-7.4	-6.4	-3.3	-4.9	-9.3	-5.2
Mexico	CG WP	-3.2	-7.0	-12.9	-8.6	-7.7	-8.2	-13.2	-14.3	-9.7	-5.1	-2.8	-3.5	4.8	0.8	-0.4
Nicaragua	CG	-9.3	-11.7	-13.2	-28.7	-23.6	-22.4	-17.3	-16.6	-26.6	-6.7	-17.1	-7.5	-7.6	-7.3	-9.7
Panama	CG	-9.3	-7.8	-12.9	-5.7	-6.7	-2.1	-1.9	-4.5	-5.3	-7.0	-0.7	-2.7	-1.4	-0.4	-0.8
Paraguay	CG	0.3	-2.2	-0.1	-2.0	-2.5	-1.2	1.0	-0.2	0.7	1.5	3.0	4.4	-0.1	-0.7	0.8
Peru	CG	-2.4	-4.0	-3.2	-7.5	-4.4	-2.2	-3.7	-5.7	-2.5	-4.2	-2.5	-1.4	-1.4	-1.6	2.1
Dominican Republic	CG	-2.9	-2.3	-3.1	-2.8	-0.9	-1.5	-0.5	-2.2	-1.6	-0.1	0.3	2.8	2.9	-0.4	-1.1
Uruguay	CG CPS	-	-1.5	-9.1	-3.9	-5.2	-2.9	-1.2	0.1	-2.0	-3.4	-0.1	0.4	0.3	-1.1	-2.3
Venezuela	CG NNFPS	-0.2	2.8	-1.1	-2.0	2.5	2.3	-0.5	-5.0	-6.2	-1.0	-2.1	2.8	-3.6	-3.4	6.5
					-2.4	6.8	3.2	-5.3	-4.4	-8.6	-1.1	0.2	0.2	-5.8	-3.5	-13.8

Source: ECLAC, on the basis of official figures.

<sup>a</sup> A minus sign (-) indicates a deficit.

<sup>b</sup> The meanings of the abbreviations given in this table are as follows: NNFPS = national non-financial public sector; NFPS = non-financial public sector; WP = hypothetical situation of no income from privatizations was registered; CPS = consolidated public sector; CG = central government.

the point where the relevant countries have had to undertake extremely costly bail-outs. Furthermore, the chosen mode of fiscal adjustment, which has at times relied too heavily on spending cuts, has severely curtailed social and infrastructure investment and has driven down public-sector wages as well as seriously impairing the quality of that sector's performance.

The countries' fiscal positions have at times been distorted by the practice of recording non-recurring profits from privatizations above the line, rather than as a form of deficit financing.<sup>5</sup> This artificially lowers the government deficit and distorts the change in the public sector's net assets.

Thus, a failure to draw a proper distinction between temporary and permanent factors may undermine fiscal stability. This is because fiscal positions may appear to be well balanced only because temporarily high external income levels may spur economic activity and boost tax receipts. If the incoming resources are not saved and are –worse yet– used to finance current expenditure, pressure for excessive expenditure may build up which will later –once external credit levels have returned to their trend values– have to be siphoned off.

#### 4. A shortfall of domestic savings

Although to differing degrees in each country, saving rates and, in particular, investment levels tumbled in the 1980s. These coefficients have been making a gradual recovery during the 1990s, but have yet to reach their pre-crisis levels in most of the countries.

Studies on the subject<sup>6</sup> underscore the fact that, although interest rates do contribute to a more efficient use of available resources and help to regulate capital movements, they do not have any decisive effect on savings levels; in order to influence saving rates, policies are needed that will reinforce the complementarity between external and national saving and between public and private saving.

<sup>5</sup> In macroeconomic terms, financing a deficit with the proceeds from privatizations is equivalent to borrowing via public bond issues. This is because the sale of government assets alters the Treasury's asset position, on the one hand, and, on the other, absorbs private-sector savings, thereby having much the same effect on the financial market as an issue of public debt would have (Marcel, 1989).

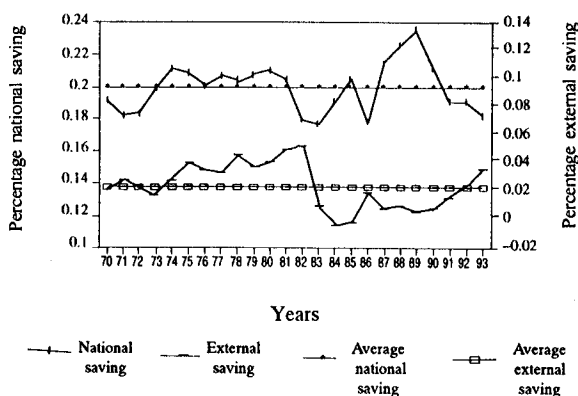
<sup>6</sup> References on this topic include two overviews prepared by ECLAC: Massad and Eyzaguirre (1990) and Held and Uthoff (1995).

Saving activity in the region exhibits three main characteristics: i) it tends to level out at a rate of about 20% of GDP; ii) any increase in external saving tends to crowd out national saving; and iii) public saving tends to partially crowd out private saving.

In other words, conflicts have arisen in the region among the various sources of savings. An upturn in public saving has largely offset the decline in private saving. At the same time, a disproportionate amount of the increase in real disposable income generated by the region's larger inflows of external savings has been channelled into consumption and has thus gained ground at the expense of all the various forms of national saving (see figures 1 and 2).

FIGURE 1

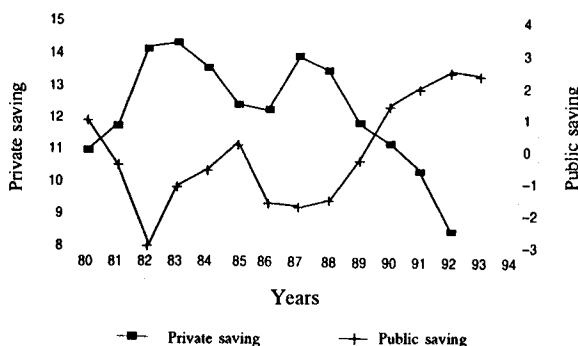
**Latin America and the Caribbean: indicators of national saving and external saving at current prices (As percentages of GDP)**



Source: ECLAC, on the basis of official figures for 15 countries.

FIGURE 2

**Latin America and the Caribbean: indicators of private saving and public saving at current prices (As percentages of GDP)**



Source: ECLAC, on the basis of official figures for 11 countries.

Gross national saving, measured as a percentage of GDP (at current prices), was fairly stable during the period 1974-1981, when high levels of international liquidity gave the countries access to external financing (and more specifically, bank loans). Then, when the debt crisis engulfed the region and an adjustment had to be made in economic activity in order to cope with the interruption of external financing, gross national saving declined. Later on, it picked up again as the per capita level of disposable income rebounded, but its upward climb came to a halt when the region regained access to external capital markets in the early 1990s.

Cyclical variations in income tend to have a marginally positive impact on saving and, hence, a strong effect on consumption.<sup>7</sup> In other words, it has been the region's experience that external or internal shocks that lead to a "temporary" increase in income have the effect of significantly raising consumption levels, causing national saving to fall.

External saving's negative effect on national saving is greater when external saving rises above its trend value.<sup>8</sup> National saving's negative response to cyclical swings in external saving suggests that the types of linkages maintained with international financial markets have a significant influence on national saving levels.

The substitution of external saving for national saving has been greater in countries whose re-entry into international capital markets in the early 1990s prompted them to adopt macroeconomic policies which have led to serious over-spending (in relation to national income) and which have relied on increasingly sharp currency appreciations to promote stabilization.

The influx of financial capital has not been balanced out by a matching creation of production assets, thereby generating a wealth effect owing to the

steep rise in prices of existing assets. Consequently, capital inflows have engendered a stronger inclination to consume.

## 5. A weak investment effort

At the start of the 1980s, the region's average investment rate was verging on 23.5% of GDP. Following the economy's adjustment to the effects of the external debt crisis, it fell to 16.6% of GDP in 1985 and continued to slide until reaching a low of 15.9% in 1990. Since then it has been making a gradual recovery, rising to 22% of GDP in 1994-1995, but this is still below its pre-crisis level.<sup>9</sup>

As a consequence of the countries' adjustment policies and, later, the steps they took to redirect the focus of economic policy, the crucial consideration in private investment decisions came to be policy stability and economic agents' degree of certainty. Under these circumstances, the effectiveness of the countries' efforts to close the external financing gap was a decisive factor in stabilizing macroeconomic variables and new investment incentives. The fact that investors have been slow to respond to these new incentives may, in part, be attributable to misguided policy sequencing or inconsistencies in economic policy or reforms that may have affected the stability or predictability of relative prices. The greater the degree of uncertainty, the greater the benefits of bidding one's time and, hence, the slower the response of investment to an improvement in macroeconomic conditions (see table 3).

A comparison of 1978-1981 with 1990-1994 indicates that all the countries for which information is available have witnessed a steep downturn in public investment (measured as a percentage of GDP)<sup>10</sup> with the sole exceptions of Colombia, where it has held steady, and Costa Rica, where the decline has been very slight.

<sup>7</sup> If very little is saved out of temporary income inflows, the implication is that the marginal propensity to consume diverges from zero, which runs counter to the permanent income hypothesis. Although the deviation of income from its trend level has a positive influence on saving, its coefficient is in the vicinity of 0.20, which means that in order to increase saving by one point of GDP, measured income would have to exceed its trend levels by five points.

<sup>8</sup> A one-point rise in external saving above its trend level drives national saving down by around one half point of GDP (ECLAC, 1996a, p. 45 and table IV.1).

<sup>9</sup> Chile, Colombia, Costa Rica and El Salvador are the only countries in which the rate of gross fixed capital formation for 1990-1994 was equal to or higher than it was before the external debt crisis.

<sup>10</sup> The steepest decreases were in Mexico (from 11% to 5% of GDP, for a drop of 6 points), Argentina (4.6% of GDP), Brazil and Venezuela (3 points each).

TABLE 3

**Latin America (17 countries): evolution of  
gross fixed capital formation and GDP, 1978-1994**

Country	Gross fixed capital formation <sup>a</sup> (Index, average 1978-1980=100)				GDP <sup>a</sup> (Annual average variation over the period)				Gross fixed capital formation as a proportion of GDP <sup>b</sup> (Percentages)			
	1978- 1981	1982- 1984	1985- 1989	1990- 1994	1978- 1981	1982- 1984	1985- 1989	1990- 1994	1978- 1981	1982- 1984	1985- 1989	1990- 1994
Argentina	97	73	67	82	0.3	0.9	-0.9	6.1	24.0	18.1	16.2	19.0
Bolivia	95	52	68	81	0.4	-3.1	1.3	4.0	16.6	9.9	13.3	14.3
Brazil	99	80	94	84	4.4	1.1	4.5	1.0	22.5	17.5	17.0	15.5
Chile	111	82	130	229	7.2	-3.1	6.1	5.7	17.4	14.0	17.8	22.3
Colombia	104	121	128	157	5.0	2.2	4.8	4.0	16.3	17.6	15.6	16.0
Costa Rica	93	61	90	135	2.3	1.1	3.8	4.7	24.5	16.5	21.3	24.5
Ecuador	99	79	76	80 <sup>c</sup>	5.3	0.7	2.2	3.3	23.2	17.2	15.2	14.1
El Salvador	92	57	72	91 <sup>c</sup>	-3.2	-0.9	1.5	4.2	15.2	11.2	13.3	16.6
Guatemala	100	70	66	85 <sup>c</sup>	3.7	-2.0	2.2	3.8	13.5	9.5	8.6	9.7
Honduras	95	74	78	113 <sup>c</sup>	5.2	0.5	3.9	2.6	24.5	18.2	16.9	21.9
Mexico	109	92	86	119	9.2	-0.4	1.1	3.0	23.9	18.6	17.2	20.8
Panama	108	111	84	120 <sup>c</sup>	8.3	1.6	-1.1	6.5	21.4	18.7	13.6	17.8
Paraguay	110	102	106	135 <sup>c</sup>	10.5	-0.2	4.2	2.9	25.8	21.4	19.9	21.4
Peru	109	104	89	89	3.9	-2.3	-0.2	2.8	22.9	22.0	17.6	19.7
Dominican Republic	100	87	114	129 <sup>c</sup>	4.0	2.2	4.4	1.8	22.5	22.0	21.6	21.1
Uruguay	102	66	49	71	4.9	-5.5	3.9	3.7	17.2	12.7	9.7	12.5
Venezuela	96	64	55	60	-1.1	-2.7	1.7	3.8	29.2	20.1	15.9	16.1

Source: ECLAC, on the basis of official data.

<sup>a</sup> In 1980 dollars.

<sup>b</sup> Coefficient in constant currency of each country.

<sup>c</sup> Average 1990-1993.

This slump in public investment has not, for the most part, been counterbalanced by a matching upswing in private investment; in Brazil and Venezuela, the decrease amounted to 4 and 10 points, respectively. <sup>11</sup>

The orderly way in which the external imbalance was financed had a strong influence on economic agents' expectations and helped to allay their uncertainty. A few countries were successful in procuring support from multilateral agencies (Chile) or obtaining unrequited transfers (Bolivia and Costa Rica), which allowed them not only to renegotiate their debts with the private international banking system

but also to secure external credit for an expansion of imports. Thus, the availability of external finance proved to be a decisive factor in the performance of private investment.

In 1991, the strong reactivation of international capital flows into the region began to reverse the downward trend in external variables. The resulting recovery, which took place within a framework of greater stability and receding external constraints, helped to boost investment rates. The (initially hesitant) increase in FDI and in the public sector's savings effort also contributed to the growth of investment.

The furtherance of the economic reform process, progress towards fiscal and price stability, and the liberalization of foreign capital regimes helped to create a favourable climate for the resumption of FDI streams.

Until the 1980s, Latin America and the Caribbean received the lion's share of total developing-

<sup>11</sup> Measured as a percentage of GDP, Chile's level of private investment in 1990-1994 was twice what it had been in 1978-1981 (16.8% versus 8.2%). Comparisons based on much the same time periods reveal that figures for recent years have surpassed the pre-crisis rates in Costa Rica, El Salvador and Mexico (up to 1994, in this last case).

country FDI inflows. During the 1970s, the region received twice as much FDI as the developing Asian countries did, but this situation was later reversed by the region's debt crisis and the upsurge in the Asian countries' incoming FDI flows after 1986. This put the latter in a better position to take advantage of the worldwide boom in FDI that began in 1987 and continues to the present day.<sup>12</sup>

The Latin American and Caribbean region's reinstatement as a participant in FDI flows has been a gradual process. Incentives (discounts based on debt-equity swaps, privatizations) played an extremely important part in the resumption of such flows into Mexico in 1986-1988 and Chile in 1985-1990. Thereafter, these flows returned to "normal" –until the crisis of December 1994 in the case of Mexico; they have remained so in Chile– and have since expanded considerably, although they do tend to be heavily concentrated in certain countries and sectors.<sup>13</sup>

## 6. Lags in employment and social equity

The backlog of social needs that built up during the preceding development stage has been compounded by the after-effects of the crisis (e.g., lower wages, higher unemployment and the various forms of underemployment). Throughout the 1980s almost all the countries experienced a severely regressive redistribution of income and a slump in per capita income levels which resulted in a considerable expansion of urban poverty.

The steps taken to restructure the countries' production sectors in the wake of the adjustment process, changes in relative prices, and trade liberalization have not yet generated a sufficient level of job creation or a satisfactory reduction in inequalities. Indeed, in many

countries, indicators of social equity have still not regained their pre-crisis levels (see table 4).

The process of modernizing production is taking place at a time when the region's structural heterogeneity is on the rise, as it witnesses a further widening of the already striking productivity gap between large companies and the varied group of activities that are lagging behind. The bulk of new job creation continues to take place in low-productivity, low-wage sectors, while the share of employment accounted for by formal activities is shrinking. In a parallel process, the range of wage rates has increased as a function of workers' differing levels of education and skills, while the incomes of own-account workers –and specifically those of the non-professional/non-technical members of this group– are falling in relative terms (ECLAC, 1995d).

The fiscal adjustment of the 1980s brought reductions in the level of social expenditure and in the quality of social services (ECLAC, 1994), and this has affected the coverage and effectiveness of social policies. By the same token, these policies have lagged behind in qualitative terms because they have not been adapted to meet the challenges posed by the new style of economic policy.

The new operational mode of the region's economies has exhibited regressive trends in income distribution. These tendencies may be a temporary phenomenon that could disappear once the economies' new production and occupational base has been consolidated.<sup>14</sup> It is also possible, however, that they are inherent traits of the new development style. Accordingly, these trends should be carefully monitored and may call for preventive or corrective policies in the future.

<sup>12</sup> Between 1970-1974 and 1990-1993 the developing Asian countries' share of worldwide FDI flows jumped from 4.6% to 14.8%, whereas Latin America's tumbled from a peak of 13% in 1975-1979 to a low of 6% in 1985-1989 before rebounding to 8.6% in 1990-1993. Thus, the region has still not regained the relative position it occupied prior to the debt crisis.

<sup>13</sup> Up to 1993, of the seven countries for which the fullest information is available, Mexico and Argentina took in over two thirds of the region's total incoming FDI (37% and 34%, respectively).

<sup>14</sup> Of those economies that are already functioning within these new macroeconomic and regulatory scenarios at points fairly close to the production frontier, only Colombia (temporarily) and Uruguay have recorded inequality indicators that are lower than they were before the crisis. Chile, which has maintained high, stable growth rates since 1985, boasts significant reductions in poverty, but its indicators of inequality are similar to or above their pre-crisis levels.

TABLE 4

**Latin America and the Caribbean: Indicators of well-being  
in the 1980s and early 1990s**

Country	Year	Real per capita income (indexes)	Poverty (% of households)		Income concentration in urban areas (Gini coefficient) <sup>a</sup>	Utilization of labour force <sup>b</sup> (indexes)	Real wages (indexes)	Per capita social expenditure (indexes)
			National	Urban				
Countries with per capita incomes above their pre-crisis levels								
Colombia	1980	100	39	36	0.518	100	100	100
	1986	105	38	36	0.455	92	120	109
	1990	112	...	35	0.450	99	118	117
	1992	113	...	38	0.454	96	116	128
	1994	121	...	...	...	94	122	...
Costa Rica	1981	100	22	16	0.328	100	100	100
	1990	103	24	22	0.345	103	98	112
	1992	110	25	25	0.362	106	97	96 <sup>c</sup>
	1994	116	...	...	...	97	112	...
Chile	1981	100	...	...	...	100	100	100
	1987	90	39	38	0.485	100	87	85
	1990	103	33	33	0.471	108	96	82
	1992	111	28	28	0.474	110	106	97
	1994	118	24	24	0.479	106	114	...
Uruguay	1981	100	11	9	0.379	...	100	100
	1990	90	...	12	0.353	...	85	101
	1992	101	...	8	0.301	...	91	118 <sup>c</sup>
	1994	108	...	...	...	...	96	...
Countries with per capita incomes below their pre-crisis levels								
Argentina	1980	100	9	5 <sup>d</sup>	0.365 <sup>d</sup>	100	100	100
	1990	72	...	16 <sup>d</sup>	0.423 <sup>d</sup>	88	77	75
	1992	85	...	10 <sup>d</sup>	0.408 <sup>d</sup>	85	79	89
	1994	95	...	...	...	72	78	...
Brazil	1979	100	39	30	0.493	100	100	100 <sup>c</sup>
	1990	98	43	39	0.535	94	116	125
	1994	100	...	...	...	85	108	...
Mexico	1981	100	...	...	...	100	100	100
	1984	88	34	28	0.321	96	72	66
	1989	83	39	34	0.424	86	73	59
	1992	88	36	30	0.414	86	86	74 <sup>c</sup>
	1994	88	...	...	...	82	97	...
Panama	1979	100	36	31	0.399	...	100	...
	1989	93	38	34	0.460	...	114	...
	1991	85	36	34	0.448	...	111	...
	1994	90	...	...	...	...	112	...
Peru	1979	100	46	35	...	...	100	100 <sup>c</sup>
	1990	72	...	...	...	...	44	40
	1994	81	...	...	...	...	46	...
Venezuela	1981	100	22	18	0.306	100	100	100
	1990	75	34	33	0.378	93	48	65
	1992	76	33	32	0.380	94	47	...
	1994	70	...	...	...	85	36	...

Source: ECLAC, on the basis of official figures.

<sup>a</sup> Calculated on the basis of the household distribution of per capita income, by deciles.

<sup>b</sup> Percentage of the non-agricultural labour force employed in formal activities.

<sup>c</sup> 1991.

<sup>d</sup> Metropolitan area (Greater Buenos Aires).

<sup>e</sup> 1980.

## IV

### The restructuring of production and competitiveness

Thanks to the countries' economic reforms and the resumption of external resource flows, in the 1990s the region's level of economic activity has risen at a moderate yet steady pace<sup>15</sup> and the countries' growth rates have been converging. During these years, investment has also been making a gradual comeback (although sharp differences exist from country to country), economic units have undertaken a sweeping rationalization of production, and total factor productivity has increased.

In a number of cases, labour productivity has made significant gains, although in some instances these advances have been due to a cyclical recovery or a steep drop in inflation. This is a transitory component of productivity whose future level cannot be projected with any confidence.

The region lags far behind industrialized countries and the newly industrializing economies (NIES) of Asia in terms of productivity. This gap, which is evident in a majority of the region's companies and sectors as well as in both the hard and soft technologies they employ, has, generally speaking, been widening in recent years.

If something is not done about these lags, sharp distributive differences in the production base may arise which will be virtually impossible to redress by means of social policy. It is in this area that productive development policies may play an important role in achieving improvements in productivity which are not divorced from considerations of social equity.

#### 1. Slow advances in productivity

During the period from 1950 to 1980, Latin America grew more rapidly than the industrialized countries, with the exception of Japan. Labour productivity and

total factor productivity rose less than in those countries, however, thus attesting to the presence of a very substantial lag in technology. Consequently, technical progress generated only one seventh of Latin America's growth during that period.<sup>16</sup>

This situation stands in contrast to the trends observed in such other regions as those of the Asian NIES and the members of the Organization for Economic Cooperation and Development (OECD), where total factor productivity not only rose more rapidly but also continued to do so even in the 1980s. During the years of fastest growth (1950-1973) in Latin America, the rate of increase in total factor productivity was only half of what it was in the Asian NIES and the member countries of the OECD. Between 1950 and 1994, the contribution to regional growth made by technological advances was a scant 0.6% per annum, versus 2.8 points for the Asian NIES and OECD<sup>17</sup> (see table 5).

Labour productivity rose at an annual average rate of 3% during the 1960s and 1970s thanks to the general tendency to incorporate more capital into the region's economies. The rate slipped in the 1980s, but then began to rebound in the 1990s in some countries, particularly Argentina and Chile.

The severe slump in growth during the 1980s drove down productivity as a consequence of the underutilization of factors of production. In addition to the effects which economic stagnation and the downswing in investment had on productivity, the region also fell further behind the international frontier of productive efficiency.

<sup>15</sup> The average annual growth rate for the countries of the region was 3.6% in 1990-1994. The rate's steep drop to a meagre 0.6% in 1995 was almost entirely attributable to the recessions experienced by Argentina and Mexico, since economic activity in the rest of the countries climbed by more than 4% (ECLAC, 1995a).

<sup>16</sup> Total factor productivity in the region climbed at an annual rate of 1.2% between 1950 and 1980; it showed zero growth between 1973 and 1980, and declined during the 1980s. In 1989-1994, it exhibited a slight upturn (1.1%).

<sup>17</sup> Of the 4.3% average annual growth rate for the region's GDP recorded for the period 1950-1994, approximately 35% was attributable to the expansion of the volume of physical capital, 10% to improvements in labour quality (mainly as a result of higher levels of education), 31% to increased employment and only 14% to technological progress.



TABLE 5

**Latin America (6 countries): international comparison of growth and total factor productivity, 1950-1994**  
(Mean variation between annual averages)

Country	Gross domestic product <sup>a</sup>		Factor productivity: labour <sup>b</sup>		Factor productivity: capital		Total factor productivity	
	1950-1980	1989-1994	1950-1980	1989-1994	1950-1980	1989-1994	1950-1980	1989-1994
Latin America	5.3	4.0	3.6	3.7	6.2	2.3	1.2	1.1
Argentina	3.8	6.1	2.1	2.3	4.9	0.8	1.0	4.5
Brazil	7.0	0.9	4.4	2.8	9.8	2.3	1.2	-1.6
Chile	3.4	6.4	1.8	4.1	4.0	4.7	1.1	2.5
Colombia	5.1	4.3	3.6	4.0	4.1	3.5	1.7	0.8
Mexico	6.5	3.0	4.4	3.7	7.7	2.4	1.5	0.1
Venezuela	5.9	3.6	5.2	5.5	6.6	0.2	0.7	0.3
Asian countries	7.7	7.6	5.0	1.5	6.7	7.4	2.6	4.4
Japan	8.0	3.8	1.8	1.7	8.7	10.5	4.3	-0.4
Rest of OECD countries	4.1	1.7	0.1	0.5	5.5	3.0	2.4	0.5
United States	3.3	1.7	1.7	0.9	3.3	2.2	1.3	0.5

Source: ECLAC, on the basis of estimates prepared by Hofman, "Economic growth and fluctuation in Latin America. The long run", paper presented at the Conference on Development Strategy after Neoliberal Economic Restructuring in Latin America, Miami, North-South Center, University of Miami, 1995; and "Capital stock in Latin America: a 1994 update", *Cambridge Journal of Economics* (at press).

<sup>a</sup> In 1980 dollars.

<sup>b</sup> The labour factor includes increases in the average number of years of schooling.

In agriculture, the productivity of land and labour has improved substantially in the region,<sup>18</sup> but is still well below the levels seen in Europe, United States, Canada and Japan. The productivity of farm labour is only one third as high as it is in Europe and a scant 7% of the level achieved in United States/Canada. What is more, far from narrowing, this gap actually widened in 1970-1990; this was especially true of labour productivity and somewhat less so in the case of per-hectare land productivity.<sup>19</sup>

At the international level, the mining industry has exhibited a tendency towards an increased concentration of ownership as large transnational corporations increase their presence in the sector and continue to redeploy a portion of their activities to developing areas. This, in combination with the natural advantages enjoyed by the region's mining sector and the efforts it has made to promote foreign investment, has helped the region's large-scale mining enterprises to increase their level of technological development in keeping with the

international frontier in these areas, including a greater concern with the use of environmentally sustainable production processes.<sup>20</sup>

On this basis, the region's mining industry has acquitted itself well from three basic standpoints: the development of physical production, the region's share of world output, and the industry's technological development.<sup>21</sup> This trend is being reflected in an increasing degree of local processing of mining products and in greater internal production linkages which are having very substantial multiplier effects in terms of the generation of value added.

The productivity of the manufacturing sector is on the rise. In the second half of the 1980s its growth was even higher than the rates achieved in the 1970s, and in the 1990s its gains in productivity have outshone anything accomplished in the two preceding decades, although it is true that the performance of medium-and large-scale enterprises in the larger economies have strongly influenced these results.

<sup>18</sup> The strongest performances in the agricultural sector have been turned in by oilseeds (soya and sunflower), but a number of other commodities (meat, maize, vegetables and fruit) have also done very well.

<sup>19</sup> The reasons for this relative lag include the insufficient use of fertilizers and improved seeds, the low level of mechanization and, particularly, the marked heterogeneity which exists in relation to access to land, irrigation and credit.

<sup>20</sup> Reasons for this redeployment include the depletion of high-quality reserves in industrialized areas, the continuing decline in the prices of major mining products on the international market, and stricter environmental standards in the countries belonging to the Organization for Economic Cooperation and Development (OECD).

<sup>21</sup> Especially in the cases of copper, tin, iron ore, silver and zinc.

This improvement has, in part, been based on a fuller utilization of installed capacity and, above all, on changes in the way production activities are organized. In other words, this upswing has been achieved with relatively few new investments thanks to considerable technical changes of a "disembodied" nature (not directly linked to the incorporation of new capital goods, although they do entail complementary investments) which have led to a reduction in employment.

## 2. Internal productivity gaps widen

During the 1980s the region's mounting structural heterogeneity was manifested with particular clarity in plummeting levels of labour productivity in the services sector. A large part of the labour force that was affected by the increasing instability of employment during this period sought refuge in low-productivity activities in the tertiary sector.

At present, signs of increasing economic concentration and structural heterogeneity are to be observed which are being reflected in large and persistent cross-sectoral productivity gaps.

The productivity of the farming and livestock activities that are conducted primarily by small- and medium-scale producers in temperate-zone ecosystems is nearly on a par with their developed-country counterparts. In addition, the region's commercial agricultural sector is developing modern agribusinesses which represent a new form of internationalization. In contrast, the productivity gap between international standards and the crops typically grown by subsistence farmers in a wide variety of agro-ecological systems is enormous.

The mining sector's buoyancy is not shared by small- and medium-scale enterprises, whose technological level is lagging further and further behind that of the large-scale mining concerns which are positioned on the international technological frontier. In the manufacturing sector, the rapid productivity growth seen in the 1990s has been concentrated in medium- and large-scale industries, and the gap between them and the small firms and micro-enterprises that account for the bulk of industrial employment is widening. In the tertiary sector, telecommunications and financial services are being radically restructured in many countries of the region, and these changes are prompting sharp gains in productivity in these activities. In some countries, such as

Argentina, Colombia and Chile, this has helped to bring about a considerable improvement in the tertiary sector's average labour productivity. In most cases, however, the expansion of low-productivity activities (non-professional, non-technical own-account workers and micro-enterprises) continues to be the mainstay for increases in employment in the sector as a whole. The coexistence, in many countries, of a rapid modernization process in some tertiary activities and an expansion of informal activities points to a widening of productivity differentials within this sector.

A comparison of gains in productivity for the secondary sector as a whole (mining, manufacturing and construction) between 1990 and 1993 with productivity growth rates for large- and medium-scale manufacturing enterprises shows that the former are far below the latter. If, in addition, the increases in this variable observed in large-scale mining activities are taken into consideration, the conclusion to be drawn is that labour productivity in small- and medium-scale manufacturing, construction and, probably, small-scale mining dropped sharply during this period.

A greater concentration of production activity is also to be observed in companies belonging to large national or transnational conglomerates. This is partly because of the greater capital-intensiveness associated with the more rapid growth of commodity-producing industries, but it is also due to the concentration of vast amounts of financial resources, the realization of capital gains and the attraction of new sorts of quasi-rents by the small number of huge multisectoral conglomerates which formed in most of the countries during their structural reform and adjustment processes and which, in many cases, have profited from privatization drives that did not do enough to ensure competition.

## 3. Sectoral changes

The recovery seen in the 1990s has, generally speaking, embraced all the sectors of the economy.<sup>22</sup> Among the producers of tradable goods, the mining industry has made an outstanding showing, while producers of non-tradables (e.g., power, construction, transport)

<sup>22</sup> The most glaring exception is community and social services, whose level of activity has lagged quite far behind as a consequence of the curtailment of current fiscal expenditure and the rationalization of employment in the public sector.

have outperformed the rest of the economy by a wide margin. The manufacturing sector has lost ground, in terms of its share of GDP, to natural resource-based activities and to non-tradable goods and services.

A greater propensity to absorb technical progress has been most closely associated with natural resource-based activities; this is particularly true of the mining industry, but also applies to the rest of the primary sector. The introduction of new technology has been intense throughout the agricultural distribution chain (which includes packing houses, cold storage and processing facilities, and shipping, among other stages), in the fishery and forestry industries and in tourism activities in the Caribbean.

The restructuring of the manufacturing sector has brought about a shift away from a metalworking-based pattern of specialization<sup>23</sup> and towards a pattern that is gradually being geared to natural resource-intensive industries. Although these are not entirely new branches of industry, during the second half of the 1970s and in the 1980s they spawned a new generation of highly modernized, more capital-intensive industrial plants employing state-of-the-art technology (aluminium, petrochemicals, paper and pulp, iron and steel, non-ferrous metals, foodstuffs). These new machine-paced, continuous-flow factories are comparatively less labour intensive than metalworking industries and make relatively less use of systems engineering techniques for organizing production and determining production methods.

In addition to the metalworking industry's lower profile, this transition has also been associated with a decline in the production of textiles, leather and footwear. Production activities involving a high degree of value added and an intensive use of in-house engineering services, such as capital goods and fine chemicals, have also been scaled down.

An increase in the supply and quality of natural resources has prompted a rapid expansion of the industries that process these materials. As a rule, these new industrial plants have confined their activities to the initial processing stages rather than moving on to

higher levels of local value added or the manufacture of special products (such as high-grade paper, hydrogenized or low-cholesterol oils, specialized steel products, aluminium angles or sections, instant coffee, copper alloys, etc.), which have tended to remain in the hands of foreign buyers.

#### 4. Corporate restructuring

In each country there is one group of firms –which, although few in number, play an important role in terms of their contribution to GDP– that are reacting “proactively” to changes as they take place; in other words, these companies are adapting to the new conditions in their environment and have significantly altered their operational procedures and expanded their investments and production capacity through the use of new types of facilities and organizational production models. A second group is reacting “defensively”, adapting to new conditions by making minor changes in the areas of organization, subcontracting or outsourcing and vertical delinking but not undertaking any major investments or expansion of installed capacity. A third group –the largest in number but with the smallest share of GDP– does not have the capacity, information or resources its members would need to adapt to changing circumstances; as a result, some of the firms in this group have disappeared while others are sinking fast.

Among the subsidiaries of transnational manufacturing enterprises operating in the region, the vast majority have opted for strategies based on a defensive reorganization involving the use of information and management technologies, cost-cutting measures, manpower reductions, and the suspension of any further major investments (Mortimore, 1995).

The macroeconomic imbalances of the 1980s sent out signals which led economic agents to focus their attention on financial and speculative operations more than on technology. Uncertainty as to the permanence of economic reforms led them to emphasize short-term decisions and to veer away from investments having longer lead times or involving more risk or uncertainty; this led to a decline in investments in modern technologies and equipment associated with new product designs and research and development (R&D) activities.

By virtue of their competitive advantages –which stand out more clearly now that the countries have shifted the focus of their development strategies– and their absorption of new technology, industries that

<sup>23</sup> The metalworking complex encompasses a cluster of industries primarily concerned with technical sub-processes for producing and assembling metal parts and sub-components. All these activities are labour intensive, require skilled workers, and make use of industrial engineering services for organizing production and designing the production methods to be employed. They include manufacturers of consumer durables, motor vehicles, fairly simple capital goods such as engines and boilers, farming equipment, equipment used by the food-processing industry, etc.

process natural resources and producers of basic, widely-used manufactures both occupy extremely strong positions within the new structure of macro-economic incentives.

### 5. Institutional reforms and the modernization of services

Trade liberalization, market deregulation, privatization and the elimination of obstacles to foreign investment, together with the dynamic created by technological progress and the development of new forms of corporate organization, are bringing about institutional changes that make it necessary for us to re-draw the conventional dividing lines between tradable and non-tradable goods and services and, indeed, between goods and services as such.

The exportation of financial, engineering and consulting services has converted many such former non-tradables into tradables. So too, the mobilization of financial resources (in some cases, pension funds, and in others, bond and equity issues on local or international markets) has deepened capital markets and has in some instances promoted investment in neighbouring economies. Recent privatizations of power and telecommunications utilities have helped set in motion major productive investment processes that have galvanized these sectors as well as the construction and transport industries.

The current trend towards subcontracting or outsourcing services is boosting the volume of transactions between the services sector and other sectors of the production system and is building up the markets in which these transactions are conducted. This process is leading to the emergence of industrial-scale service activities.

The production of commodities and basic manufactures for export places enormous demands on a country's road and rail, port and communications infrastructure, and this is one of the reasons why the transport, storage and communications sector has, on average, grown twice as fast as GDP since 1980. The same is true of the electricity, gas and water sector, which has become one of the most rapidly growing industries in the economy since 1980 due to the energy needs of new natural resource-based production activities and to the discovery of new non-renewable sources of energy.

Privatizations and the deregulation of domestic markets are shaping a new economic arena in which private agents interact with public policies and in

which institutions find themselves faced with emerging challenges in relation to regulation and the promotion of competition.

The privatization process has involved a wide variety of sectors. It began with a cluster of dissimilar firms positioned within competitive markets, but then spread to manufacturing concerns, financial services, transport companies and natural resource-related enterprises. More recently, the wave of privatizations has spread to public utilities and infrastructure activities.

Privatization processes in Latin America have differed in terms of sequencing, speed, intensiveness, sectoral coverage and transfer mechanisms. This process has been widespread in the case of firms operating in competitive markets and of considerable magnitude in the transport and agro-industrial sectors. An analysis of the privatizations slated for the next few years clearly shows a shift towards public utilities and infrastructure activities. For example, privatizations or the formation of partnerships with private agents—in the form of operating concessions or the like—are planned in the power sector (Bolivia, Brazil, Colombia, Costa Rica, Ecuador, El Salvador, Mexico, Panama, Paraguay and Venezuela); telecommunications (Bolivia, Brazil, Costa Rica, Ecuador, El Salvador, Guatemala, Honduras and Panama; port or road infrastructure (Brazil, Chile, Colombia, Ecuador, El Salvador, Guatemala, Mexico, Panama, Peru and Venezuela); and drinking water supply (Brazil, Ecuador, El Salvador, Honduras, Mexico, Panama, Paraguay and Venezuela). A somewhat less notable emphasis on financial services, transport and natural resources is also to be noted.<sup>24</sup>

### 6. Competitiveness and exports

The region's agricultural exports continued to be concentrated in products that exhibit a very slow rate of growth in the international market place. Although a number of notable exceptions bear witness to a strong ability to

<sup>24</sup> Recent events in this area include the partial implementation of a capitalization process in Bolivia which is expected to bring in investments equivalent to nearly 30% of the country's GDP over the next seven years; partial privatizations in the telecommunications industry, natural gas distribution, hydrocarbons sector and shipping services in Brazil; privatizations in the areas of transport, telecommunications, natural gas and infrastructure in Mexico; and the use of operating concessions in the areas of infrastructure, natural gas distribution and sanitation (including waste water treatment) in Chile.

TABLE 6

**Latin America and the Caribbean: international competitiveness, 1980 and 1993**  
(Percentages)

	Latin American Integration Association (ALADI) <sup>a</sup>		Central America and the Caribbean <sup>b</sup>		East Asia <sup>c</sup>	
	1980	1993	1980	1993	1980	1993
I. Contribution (structure of exports to OECD)	100.0	100.0	100.0	100.0	100.0	100.0
Natural resources (1) + (2) + (3) <sup>d</sup>	75.6	49.2	85.1	54.0	13.1	6.4
Agriculture (1)	30.3	25.2	48.7	41.5	5.8	4.7
Energy (2)	36.1	18.6	22.5	4.9	4.9	1.3
Other natural resources (textile fibres, minerals and others) (3)	9.3	5.4	13.9	7.7	0.7	0.4
Manufactures (4) + (5)	23.1	48.1	12.2	43.0	84.7	92.1
Based on natural resources (4)	8.5	7.2	3.2	3.6	4.1	1.7
Not based on natural resources (5)	14.6	40.5	9.0	39.4	80.6	90.4
Other (6)	1.3	2.7	2.7	3.0	2.3	1.5
II. Share in OECD import market	4.4	4.1	0.9	0.6	3.5	5.9
Natural resources (1) + (2) + (3)	7.6	8.5	1.7	1.3	1.0	1.6
Agriculture (1)	9.3	8.5	3.0	1.9	1.9	2.3
Energy (2)	6.2	8.0	0.8	0.3	0.7	0.8
Other natural resources (textile fibres, minerals and others) (3)	11.3	11.5	3.4	2.2	0.7	1.3
Manufactures (4) + (5)	1.9	2.7	0.2	0.3	5.4	7.3
Based on natural resources (4)	6.7	6.6	0.5	0.4	2.5	2.2
Not based on natural resources (5)	1.3	2.4	0.2	0.3	5.7	7.6
Other (6)	3.0	4.2	1.3	0.6	4.2	3.4

Source: ECLAC, on the basis of results generated by CAN software, Country competitiveness analysis, version 2.0.

<sup>a</sup> Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Mexico, Peru, Paraguay, Uruguay and Venezuela.

<sup>b</sup> Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, Barbados, Cuba, Dominican Republic, Haiti, Jamaica, and Trinidad and Tobago.

<sup>c</sup> Republic of Korea, Hong Kong, Singapore and Taiwan.

<sup>d</sup> The numbers given in parentheses in this table refer to the following categories of the Standard International Trade Classification (Rev. 2):

(1) Sections 0, 1 and 4; divisions 21-25 and 29;

(2) Section 3;

(3) Divisions 26-28;

(4) Divisions 61, 63 and 68; groups 661-663, 667 and 671;

(5) Sections 5, 6 (except for those divisions and groups included under category 4), 7 and 8.

(6) Section 9.

move into new market niches, the region's share of world trade in agricultural products has shrunk, slipping from nearly 15% in 1980-1985 to 11.2% by 1993.

Some of the agricultural sector's most rapidly growing exports include forestry products, new export items such as fresh fruit and vegetables, and exports of a single good in a wider variety of types (fresh, chilled, frozen) or in a more highly processed form to fit the varying needs of consumer markets. All of these product lines are very strong performers in the flow of exports from the region to the OECD countries.

Mining activities in Latin America have moved into a very dynamic phase at present thanks to reforms in mining laws that have heightened the complementarity between the high yields of the region's

mines (above the world average) and the fact that its large-scale mining activities are falling into step with the pace of technical progress at the international level, thereby permitting them to take fuller advantage of these resources' rent-producing potential. A new wave of mining investment is expected that will expand the region's exportable supply.<sup>25</sup>

Since the late 1970s, the volume of exports of manufactures has climbed considerably (around 7% per year) even though the production of such goods has been flat. This fact demonstrates that the external sector

<sup>25</sup> Investment commitments in the region for the remainder of the 1990s total approximately US\$14 billion, which is almost one third of total projected mining investment worldwide for those years.

has become the most buoyant component of demand and, at the same time, that many companies have managed to redirect their output towards external markets.

Exports of manufactures played a very important role in the 1980s and have continued to expand in the 1990s in terms of both volume and value despite weakening prices for many of the basic inputs that are exported by the region (e.g., copper, pulp and fishmeal). Meanwhile, imports of manufactures, which had decreased markedly during the first half of the 1980s, have been climbing quite sharply since then. As a result, the small trade surplus posted by the manufacturing sector in 1985 gave way to a deficit in 1990 which proceeded to widen quite rapidly in the ensuing years, overshadowing the deficit recorded in 1980.

Now, in the mid-1990s, the manufacturing sector is exhibiting an increasingly widespread renewal of its growth capacity, productivity gains, a greater export capacity than in previous decades, a strong expansion of imports of manufactures and a sizeable deficit on trade in manufactures.

The Latin American countries that belong to the Latin American Integration Association (ALADI) have shifted the product mix of their exports to the OECD

in the right direction (the percentage of manufactures doubled –from 23% to 48%– and the percentage of manufactures not based on natural resources virtually trebled between 1980 and 1993). Nevertheless, their share in total imports from OECD countries declined slightly (from 4.4% to 4.1%) and the competitive position of the fastest-growing sectors showed no more than halting advances between 1980 and 1993 (from 1.9% to 2.7% for manufactures and from 1.3% to 2.4% for manufactures not based on natural resources) (Mortimore, 1995).

The Latin American and Caribbean countries have clearly lagged behind the developing countries of Asia in terms of their competitive position. Although there has been a significant shift in their export mix towards the types of manufactures that are in the greatest demand, their share of the imports of the OECD countries, especially in respect of the most dynamic product lines, has made fairly little headway. The most notable exceptions are Mexico's automotive industry and Mexico's and the Dominican Republic's EPZ (*maquila*) industries. In both cases, transnational corporations have played a prominent role (see table 6).

## V

### Policies for strengthening development

The region's public policy objectives reflect its interest in moving towards a progressive institutionalization of open, stable and competitive market economies while it strives to redress its social problems and consolidate a democratic system of government.

This complex process is also reflected in a transition towards new production structures based on the interaction of business firms, production agents, markets, sectoral policies and regulatory bodies and mechanisms. The process is notable for the speed with which its ground rules may change and the slowness with which the relevant organizations adjust to such changes. Modes of behaviour geared to the workings of a closed economy are still to be seen, as is a lack of sufficient institutional flexibility to cope with competitive challenges; in particular, many companies have been very slow to adopt quality standards, technological innovations and staff training schemes, and their industrial relations continue to

be marked by a lack of cooperativeness. Meanwhile, the public sector has been reluctant to modernize and has clung to overly bureaucratic procedures, as well as, in general, pursuing policies without providing for their assessment and allocating funds without reference to performance standards.

The gradual resumption of growth and increase in competitiveness have been accompanied by widening internal productivity gaps that represent a drain on the sector's forward momentum and limit its capacity in terms of employment and greater social equity.

Hence the importance of an approach that seeks improvements in stability, competitiveness and social equity within a framework that melds macroeconomic, microeconomic and institutional issues. This does not imply any effort to lower the profile of the macroeconomy but simply to understand its role as one of various essential preconditions for changes in

the region's production patterns. It must be coupled with the development of the corresponding markets so that the macroeconomic incentives which are to be created will serve as concrete means of stimulating productivity, innovation and the dissemination of technology, thereby reducing the heterogeneity of the sector's growth and improving the distribution of its achievements.

### 1. Boosting the growth rate

While it is true that the region attained a growth rate of 3.6% between 1990 and 1995, this is clearly not fast enough if it is to accomplish the twofold task of rectifying its problems of social inequity while at the same time stepping up its absorption of technical progress. The above-cited growth rate is not only well below the rate for 1950-1980, but also, in effect, keeps the region's poverty rate at its existing level.

ECLAC estimates that in order to reach acceptable levels of employment and productivity, GDP will need to climb at something near 6% per year, which would mean that per capita GDP would be expanding at an annual rate of around 4%.

Reaching the objective of a high and stable rate of growth will require redoubled saving and investment efforts since, in order to grow at 6% per annum, the region's average investment rate will have to be raised from 22% to 28% of GDP; furthermore, there will need to be an appropriate mix of national and external saving so that this can be done in a way that preserves the region's macroeconomic stability.

Moving gradually towards growth rates of 6% and national saving rates of around 25% or 26% of GDP (implying an increase in external saving of about 2%-3% of GDP) will be difficult, but not impossible. In any event, it is not a question of specific numbers but rather ranges or approximate levels, since the swift pace of economic change makes it hard to extrapolate from past results.<sup>26</sup>

### 2. Consolidating economic reforms

The preservation of fundamental macroeconomic balances is essential to any attempt to strengthen the development process; to this end, decision-makers

need to have an overall picture of the economy as a basis for simultaneous efforts to achieve a low and declining inflation rate; carry forward the economy's stabilization with the help of fiscal austerity measures and increases in domestic saving, investment and productivity; hold the deficit on current account within a sustainable range; and keep the real exchange rate at a competitive level.

The management of macroeconomic variables should focus on the promotion of national saving and should ensure that external and domestic saving will complement each other by achieving stable levels of external saving and channelling both sources towards funding a higher level of investment and productivity. Lowering inflation, spurring forward public and private saving, attracting long-term external capital and taking steps to ensure that the signals sent out by relative prices are such that they emphasize permanent factors and encourage investment in tradables—these are all ongoing challenges that put to the test the consistency of macroeconomic policies designed to pave the way for changes in the region's production patterns.

In addition to recognizing the significance of the inflow of external capital to the region, it is important to appreciate the dilemmas faced by the economic authorities as they strive to achieve macroeconomic stability, maintain external capital inflows, ensure their complementarity with national saving, and channel these flows into productive investment—all at one and the same time.

In order to coordinate fiscal, exchange and monetary policies within an environment marked by an increasing liberalization of various markets, the authorities have to avert any revaluation of the currency that is not tied in with long-term external equilibria. The way of accomplishing this, however, will vary depending on the particular features of the relevant macroeconomic cycle and economic policy matrix. By the same token, a consensus exists as to the need to boost national saving, but differences of opinion arise with regard to the specific policy approach to be taken to the liberalization of the capital account and government intervention in foreign exchange and money markets. Consequently, a more careful examination of the specific macroeconomic and institutional features of the situation in each country is required, since, along with the necessary increase in saving rates, the possibilities of supplementing national saving with external saving by regulating the

<sup>26</sup> In particular, it is to be hoped that economic reforms will boost the efficiency of investment and therefore permit a higher growth rate to be achieved at a given level of investment. This does not automatically follow, however, since an increase in the efficiency of financial intermediation also plays a crucial role.

flow of foreign capital are strongly influenced by those features.

Hence the relevance of an analysis that traces the links among macroeconomic, microeconomic and institutional factors for an examination of public policies and of ways of reorienting them to cope with external and internal challenges. Such an instrument is useful in dealing with the various stages of development and the differing national conditions found in the countries of the region and, as such, enriches comparative studies and helps us to avoid overgeneralizations. Nonetheless, national specificities should not blind us to the fact that the macroeconomic situation ought to manifest itself in relative price stability, credible exchange rates, positive yet moderate real interest rates and more export-led growth.

As more experience is gained in this regard, it is beginning to become clear that a strong degree of complementarity exists among policies dealing with macroeconomic variables, productive development and the promotion of competition. On the one hand, a steady decline in the real exchange rate can thwart efforts to promote technology, productivity and training, thereby leading to a reduction in competitiveness. On the other, privatization drives may enhance competitiveness by channelling support to competitive markets and strengthening the regulation of markets that tend to be dominated by natural monopolies. These are important aspects of the economic reforms which are now under way, and they deserve more attention than they are currently receiving.

### 3. Saving, investment and finance

In order to make gradual progress towards a sustained growth rate of around 6% per annum, an investment rate of nearly 28% of GDP will be required (given the region's existing productivity levels and capital mix), which is between 5.5 and 6 points more than the present average investment coefficient.

Within this growth environment, national saving is sure to increase; if it holds to the trend line observed over the past two decades, however, the upturn will not be large enough, since this would only raise the rate from 18% to 23% of GDP, and the difference of slightly more than 5% of GDP would have to be covered with external savings. One of the lessons to be learned from the Mexican crisis is precisely that countries must refrain from relying too heavily on external saving, particularly when it is

composed of short-term funds. While it is reasonable to conclude that the current status of economic reforms in the region will ensure a more stable and orderly type of access to external finance than in the 1980s, it is also clear that a current account deficit of 5% of GDP would exceed the bounds of macroeconomic prudence and, ultimately, would severely reduce the region's chances of attaining stable growth.

Hence the need to rely primarily on national saving, which should be raised to somewhere around 25% of GDP (a jump of 5 or 6 points of GDP over a period of four or five years).

Such levels cannot be reached through growth alone, since their achievement would require a shift in the saving function of such a magnitude that, at each income level, it would add another three points of GDP to the saving rate. This assumes a substantial change in behaviour patterns with regard to consumption and private saving, as well as public saving. Nor does it appear possible to attain such savings levels by relying entirely on changes in relative prices. While clearly very important, the use of relative prices should be coupled with institutional modifications all along the capital formation sequence in order to encourage all forms of saving and ensure their efficient conversion into productive investment.

To this end, the countries need institutional mechanisms that will increase the efficiency with which their financial systems attract funds, perform intermediation services and allocate resources as well as enhancing the supervision and regulation of those systems.

Not only is the region's saving rate very low in comparison to the rate achieved by Asian economies, but its forms of intermediation are also inefficient in channelling savings into productive investment.

An integrated approach to the capital formation process needs to take into account not only macroeconomic stability and the existence of a growth climate, but also the relevance and continuity of incentives, the effectiveness of the regulatory system and the quality of financial intermediation, since the aim is both to generate savings and to make it easier for these funds to be channelled into productive investment in an efficient manner.

The foregoing suggests that financial policy ought to touch upon all the links in the capital formation chain. Such a policy should actively create and promote new sources of saving and should foster a



vigorously-paced development of financial institutions and instruments while taking into account externalities, problems in terms of information, and the flaws and even actual gaps existing in the region's credit and capital markets at their current stages of development; in addition, it needs to address the demands associated with the financing of specific forms of investment (fixed investment by business enterprises, investment in infrastructure, in housing, etc.) along with the required complementary investment in human capital.

The nature of the relationship between the financial market and the capital formation process calls for institutional changes to permit the inclusion, on the one hand, of a segment of long-term operations (which would open up the field for investment in technology, for example) and, on the other, a segment that would serve the needs of small and medium-scale enterprises. Both of these segments could benefit from financial innovations that would give them access to leasing operations, collateral funds, group collateral funds for project loans, and technical assistance-tied loans.

Pension-system reform plays a special role in the promotion of private saving.<sup>27</sup> There have also been a number of promising experiments with institutional saving schemes that entitle workers to receive housing subsidies. A similar system might be used to provide preferential loans to individuals or groups working in the field of education and training; under such a scheme, social security collection systems might be used for the automatic discounting and repayment of such credits. Such a mechanism could be supplemented by secondary markets in these instruments that would pave the way for their diversification and securitization, thereby making them more attractive to the financial system.

In respect of public-sector saving, there are various possible combinations of increases in tax revenues, reductions in current public expenditure, and financial reorganizations of State enterprises and pension systems. Two countries that have managed to carry out stable external adjustment processes—Chile and Colombia—are also notable for their achievement of a lasting fiscal balance. In both cases, public ac-

counts were in better shape prior to the crisis than they were in other countries, and throughout the fiscal adjustment process, both countries continued to make basic public investments. Now, they boast the two highest levels of tax revenues and current income as percentages of GDP. These growth-based fiscal adjustments have included both a reduction and rationalization of expenditure and an increase in receipts of tax revenues and current income.

In the area of investment, interesting results have been obtained with the use of tax incentives to promote the retention and reinvestment of profits as a means of shifting the tax load from businesses to individuals. One little-used mechanism is to finance training for individuals through an equivalent tax reduction as a way of fostering investment in human capital.

Another relevant aspect in the promotion of competitiveness is investment in infrastructure, especially since the region has fallen behind in this area as a consequence of the fiscal constraints of the 1980s. Privatizations in the telecommunications and energy industries have had a significant effect and have opened the way for investments which have improved such services' coverage and level of efficiency more than could have been done with public funds. Something similar is occurring with private investment in seaports, airports and railways, although in these cases there is also a need to bolster these trends with regulatory schemes that will spur competition and reduce the possibility of vertical integration or cross-subsidization. The recent formation of public-private linkages in road-building projects and in the sanitation sector in Chile and recent privatizations in Bolivia and Peru point in this direction.

#### 4. Complementarity between external and domestic saving

The current account deficit has proved to be a meaningful indicator of the sustainability of macro-economic equilibria in open economies. It is not regarded as a cause for concern if it is moderate in size (2%-3% of GDP)<sup>28</sup> or if it is sustainable by virtue of

<sup>27</sup> Careful thought should be given to the economic and financial implications of such reforms, particularly for public and private saving, the fiscal budget, financial deepening, risk management in securities and insurance markets, and real investment.

<sup>28</sup> Chile's economic authorities have set the trend level of external saving at between 3% and 4% of GDP (Zahler, 1995), whereas Summers considers any deficit on the current account of the balance of payments in excess of 5% of GDP to be dangerous (Summers, 1996).

the fact that it is covered primarily with long-term capital inflows. Nor is it regarded as worrisome if it supplements national saving rather than taking its place, is reflected chiefly in an increase in investment rather than consumption and is invested in tradable activities that enhance a country's external payment capacity.

Measures aimed at stabilizing external capital inflows have shown themselves to be useful in averting serious distortions in key prices such as the exchange and interest rates. A number of Governments have intervened in the foreign exchange market in order to forestall just such an occurrence; in these cases, they have not simply bought up hard currency but have also neutralized the monetary effect of those purchases by issuing domestic debt paper. Chile and Colombia have encouraged inflows of long-term funds and have tried to limit inflows of short-term resources by adopting provisions specifically designed to discourage them. In 1995, Brazil and Peru also began to implement policies of this sort, although less aggressively. These policies are not without their costs,<sup>29</sup> but they have proved to be effective during transitions towards a greater degree of financial integration.

In the most prominent cases –both within and outside the region– involving the management of large volumes of external finance, the chosen approach has consisted of a series of integrated economic policy measures designed to increase fiscal restraint and boost domestic saving. These measures have included the elimination of exchange insurance, sterilization, the phasing out of capital controls and obstacles to resource outflows, a moderate appreciation of the local currency and steps to discourage an excessive inflow of short-term capital (ECLAC, 1995b).

Events in the region during recent years indicate that a combination of little or no exchange uncer-

tainty,<sup>30</sup> sterilization measures that check the convergence of interest rates, and the liberalization of capital inflows encourage the entry of short-term capital and augment its destabilizing effects (IMF, 1995).

The speed at which the capital account is opened up should be geared to the economy's absorption capacity and its ability to allocate external resources efficiently in order to safeguard the country's macroeconomic stability and avert fluctuations in the real exchange rate. A real devaluation of the currency is essential in order to ensure that the liberalization of the trade account will have the desired results and to prevent the transition in the production sector and labour market from having too high a cost.<sup>31</sup> Since financial markets adapt more swiftly than real markets do, a premature liberalization of the capital account may lead to a sharp appreciation of the currency and may send out contradictory signals regarding trade liberalization.

If financial liberalization is very sudden and sparks a massive influx of capital, then the deficit on current account may grow so large that it will have a severe impact on the country's macroeconomic equilibrium, as well as being unsustainable over the medium term. This situation is compounded by upward pressure on the price of domestic assets –real estate and stock– whose "wealth effect" spurs consumption and swells the deficit. This raises the level of country risk and heightens expectations of a devaluation. Under these circumstances, capital flows tend to reverse their direction, thereby triggering a recession or making traumatic devaluations necessary in order to rectify the external imbalance.

This having been said, it is nonetheless important to consider the specific features of each country. Past events in the realm of economic policy or the

<sup>29</sup> These include both microeconomic phenomena (e.g., less effective financial intermediation) and macroeconomic costs occasioned by the quasi-fiscal losses incurred by the monetary authority (it pays more for domestic debt than it gains on the international reserves that are amassed as a consequence of this policy). It would not be efficient to attempt to use the exchange rate to neutralize all the ramifications of such measures, even if they were considered to be temporary in nature, because this might stimulate arbitrage and reduce the manoeuvring room available to monetary policy-makers.

<sup>30</sup> In April 1994, Mexico's financial authorities replaced local-currency government securities (CETES and the like) with Tesobonos; the value of these instruments was indexed on the basis of the exchange rate, which, in practice, provided total exchange rate certainty. As a result of the delicate economic environment and the political and economic turbulence existing in Mexico, the total value of Tesobonos in circulation jumped from slightly less than US\$ 2 billion in April to nearly US\$ 29 billion in December 1994.

<sup>31</sup> Between 1987 and 1991, six countries in the region either began to liberalize their trade regimes or took steps to intensify an existing liberalization programme at a point in time when their currencies were appreciating sharply. The resulting combination of more abundant capital inflows and lower import prices triggered an inordinately large increase in imports. See ECLAC, 1992a.

nature of a country's institutional capabilities may make it inadvisable to use certain types of instruments, such as capital controls. In other cases, it may be necessary to implement an entire array of economic reforms simultaneously because of economic policy considerations, as has occurred in Bolivia and Peru; in still others, a history of hyperinflation may make it wise to use exchange anchors and adopt a system of free convertibility in order to attract external savings that will contribute to a country's stabilization and growth, as has been done in Argentina.

Be all this as it may, the reasons for not allowing the current account deficit to exceed a reasonable level still stand. In cases where external savings can serve as a source of ample support, it is all the more important to maintain a stance of fiscal austerity and to promote productivity in order to counteract overspending and the local currency's tendency to appreciate in value.

## 5. Competitiveness and productive development

Inasmuch as world trade's most buoyant components are made up of products having a relatively greater technological content (particularly non-natural-resource-based manufactures), if the countries of the region are to meet the competitive challenge, they will have to redouble their efforts to diversify their exports, incorporate more technology and productivity into those exports, and upgrade the quality and depth of the linkages existing between exports and the rest of the production sectors in the economy.<sup>32</sup>

Viewing the situation from this vantage point, ECLAC has identified a number of the questions that have been raised in the regional debate on these issues:

Is the present process of specialization simply one facet of the transition towards more technology- and human capital-intensive activities or is it an end result whose repercussions are confined to the primary sectors of the economy? What kind of effect will this specialization have on growth, employment and income distribution? Does it allow the region to

carve out a fitting position for itself in dynamic international trade flows? And, if not, what are the alternatives? What other policy options are available?

### a) Policy-making

The positions taken on this subject in the region vary a great deal, ranging all the way from advocacy of the elimination of industrial policies altogether –with the exception of those that bolster systemic competitiveness– to support for the idea of drawing up sectoral policies to supplement existing horizontal policies, i.e., those designed to further the development of capital markets.

A definite asymmetry is also to be observed in terms of the available tools for furthering productive development owing to the fact that, even though the use of the traditional sorts of instruments is on the wane, the region has not been developing other tools to take their place which would be more in keeping with today's open economies and the growing importance of multilateral agreements.

Today, the region is focusing its attention primarily on horizontal policies aimed at refining its factor markets while remaining neutral as to the types of activities or business enterprises that may be involved. This policy stance is clearly weak in certain areas, however, such as in the way sectoral situations and the issue of retooling are being handled, in supporting the activities of innovative sectors and in the degree of coordination and cooperation between the public and private sectors (Rosales, 1994).

Thus, the region's policy-makers need to strike a balance between macroeconomic discipline and productive development policies based on a clear understanding of the dangers of government intervention and the excesses of protectionism. There is a less widespread awareness, however, of market flaws or shortcomings in relation to the promotion of competitiveness and technical progress, together with a tendency to underestimate the feasibility of productive-development learning processes in the public sector.

The technical requirements of the instruments in question tend to focus on market institutions and the provision of clearly delineated incentives that decline over time and are self-eliminating once they produce their intended results, along with assessable types of performance and limited objectives that are geared to the public sector's technical and institutional capabilities (Rosales, 1994).

Accordingly, productive development policies do not attempt to "pick winners" but instead to pave

<sup>32</sup> In order to grow at an annual rate of 6%, export volumes will need to expand by no less than 10%-12%. The achievement of this level appears to be unlikely if the present export basket remains unchanged, since in 1985-1994 (a period that saw an upturn in international trade), world commodity trade was unable to top an annual growth rate of 4% (somewhat less than half the growth rate for total trade and about one third of the increase in trade in manufactures).

the way for their emergence. They are aimed at boosting total factor productivity, promoting the development and spread of technology, encouraging investment in human resources, and fostering the formation of production linkages and chains in natural resource-based activities, including tourism.

The importance of incorporating improvements in infrastructure and the promotion of competition as factors of competitiveness is one of the lessons learned from the economic reforms of the 1990s. Fiscal reorganizations and adjustments have reduced the public sector's ability to invest in infrastructure and thus open up an opportunity to explore the possibility of the private sector's involvement in financing such investments.

Promoting competition has come to be an essential part of productive development, given the fact that market efficiency is determined by a market's competitiveness, transparency and accessibility. The region therefore needs to deregulate its competitive markets, regulate those markets in which there are natural monopolies and "fill out" those of its markets that are stunted or weak, such as its markets for technology, training, long-term capital, and credit for small and medium-scale enterprises (SMES) or for investment in human resources.

The best way to spur efficiency is through competition. When this is not an option, the second-best choice is regulation. Hence the importance of encouraging regulatory agencies to make greater use of modern technologies, giving them greater autonomy and building up their institutional capabilities as a means of fostering competitiveness.

Privatizations have led to a number of advances in terms of increased efficiency and investment, and progress in these areas has been the greatest in cases where competition has been promoted by means of schemes for regulating natural monopolies that take into account rates and charges, investment, coverage, rules governing competition, and consumer protection.

*b) Systems of innovation and technological dissemination*<sup>33</sup>

The region is not allocating enough resources—in the form of funding, incentives and institutional

capacity—to the promotion and dissemination of technology. Its efforts in this area thus fail to reflect the strategic importance of technical progress for open, competitive economies, and the fact that the issue has not been placed near the top of national agendas may cause the region to fall further and further behind in terms of its competitive position.

Productivity growth is closely linked to advances in innovation and the promotion of technology and quality. Public policy therefore needs to support the development of a market for technology by building up the infrastructure for science and technology and strengthening the links between that infrastructure and the production apparatus. This idea is inherent in the concept of an "innovation system", which includes sectoral centres for technological research and dissemination, the promotion of quality, brand differentiation and design, management methods, and human resource development.

Most of what is spent on technology in the region is channelled through public-sector technological institutes and, in most cases, these expenditures are not subject to regular evaluations to determine their effectiveness or relevance. What is therefore being proposed is that a gradual transition be made towards a results-oriented system of resource allocation based on performance indicators that would introduce greater competition into the sector through the practice of putting projects out for tender.

This will probably lead to increased private participation in the management and funding of such institutes, which may give them greater autonomy and flexibility in the management of their resources as well as putting them into closer contact with the production base. Such a transition must be gradual, however, and care must be taken to safeguard basic research and areas of activity in which significant externalities exist in the public domain.

*c) Training*

A significant increase in corporate expenditure on training needs to be promoted through a reorientation of tax and financial incentives.<sup>34</sup> The content of existing training programmes is inadequate and ob-

<sup>33</sup> Previous ECLAC studies have explored such subjects as the dissemination of technology (ECLAC, 1995c, chapter VIII), the strengthening of technological infrastructure (ECLAC, 1992b, chapter V) and the funding of research and development (R&D) (ECLAC, 1990, chapter V).

<sup>34</sup> An average worker in the region only receives between two and four weeks of training during the entire 45 years of his or her working life, as compared to the 20-25 weeks of training that workers would receive if 1% of the payroll were allocated for this purpose, in accordance with internationally accepted norms.

solete, and bears little relation to what business firms actually need; furthermore, the training system's links to vocational and secondary educational systems are weak.<sup>35</sup>

It would therefore be helpful to modify certain operational aspects of the region's public training institutions in order to encourage business enterprises and employers' associations to participate more fully in defining the approaches to be taken, introducing more market-based criteria in their management, and linking up training programmes with technological programmes and priorities.

In order to further the development of the market for training, supply and demand need to be more closely coordinated; standards need to be established with regard to content, quality and relevance; and improved incentives need to be offered which will take into account the externalities associated with such investments. This undertaking can probably be accomplished more cheaply and more successfully if it is pursued on a tripartite basis in conjunction with management and labour organizations.

*d) The institutional structure and productive development*

Making the necessary adjustments in order to take up the challenge of internationalization will place certain demands on public and private institutions; the public sector will need to strengthen its commitment to the promotion of production and make a more determined export effort, and a greater degree of public-private cooperation will be required as well.

Such cooperation will help to improve the assessment and implementation of incentives, to bolster access to external markets and investments, and to deal with sectoral problems and the difficulties involved in retooling. Greater public-private collaboration is also called for in regard to brand differentiation and quality, the increased presence of private national enterprises in marketing networks

and in joint ventures with local firms in destination markets, and the need to open up the field for private investment in infrastructure.

As part of this same institutional scheme, consideration should be given to the possibility of setting up productivity centres to monitor the competitive position and technological and commercial trends of individual sectors. These would be tripartite centres formed by the Government, universities and technological centres, as one component, by employers' associations and by labour organizations, with the latter two groups representing the private sector.

Cooperation between private associations and businesses is fundamental to more effective promotion and marketing efforts, quality control and the design of private internationalization strategies. It also plays a basic role in fostering balanced labour relations that will promote training and productivity, a consensus-based form of flexibility and worker motivation, which is the foundation for the foremost competitive factor in today's economy, i.e., quality human resources.

The region's employers' associations and trade unions are relatively weak, as are its public sectors. Nonetheless, it is also true that a number of seminal and highly valuable initiatives have been undertaken that have strengthened collaboration and coordination between the public and private sectors in the area of productive development, thereby paving the way for a suitable distribution of responsibilities in those areas in which each has certain comparative advantages.<sup>36</sup>

Consensus-based schemes for the advancement of production activities have both strengths and weaknesses. On balance, however, they have helped to reduce the costs of coordination among production agents and between those agents and government policy-makers, to make information more accessible and to update incentives in this area.

<sup>35</sup> It has been suggested that flexible, modular systems should be established and that provision should be made for the mutual accreditation of courses of study pursued at secondary and vocational post-secondary educational institutions based on a grading certification system in which private and public enterprises would be directly involved. This would make it possible to evaluate the occupational relevance of what is taught and to make adjustments where necessary (Rosales, 1994).

<sup>36</sup> Examples include the Executive Chamber for Structural Matters (Brazil), the National Council on Competitiveness (Colombia), the Productive Development Forum (which has already been established in Chile and is soon to be organized in Bolivia and Paraguay), and the Andean experiments with "value-added chains".

Promoting innovations in the institutional structure and in the behaviour of social actors which are in keeping with the workings of an open economy and will contribute to the achievement of an authentic form of competitiveness is another key facet of economic reform. This represents a major opportunity for public policy to help strengthen the position of responsible, well-informed collective actors and to lend viability to the effort to forge a strategic consensus among those actors.

Productive development policies have the potential to promote both growth and social equity. In order to realize that potential, however, a greater effort will have to be made to refine the design and management of productive development policies and to evaluate such policies on an ongoing basis in order to foster a learning process within the public sector and thus increase the effectiveness of the policy tools used to promote such development.

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