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CONTENTS

Development thinking and policies: the way ahead <i>Gert Rosenthal</i>	7
<hr/>	
Macroeconomic policies for growth <i>Ricardo Ffrench-Davis</i>	21
<hr/>	
Capital flows: lessons from the Chilean experience <i>Eduardo Aninat, Christian Larraín</i>	39
<hr/>	
Changes in the industrial development of Latin America <i>José Miguel Benavente, Gustavo Crespi, Jorge Katz, Giovanni Stumpo</i>	49
<hr/>	
Pension system reforms in Latin America: the position of the international organizations <i>Carmelo Mesa-Lago</i>	73
<hr/>	
The contributions of applied anthropology to peasant development <i>John Durston</i>	99
<hr/>	
Biodiversity prospecting: a new panacea for development? <i>Julie M. Feinsilver</i>	115
<hr/>	
Foreign investment and competitive development in Latin America and the Caribbean <i>Alejandro C. Vera-Vassallo</i>	133
<hr/>	
The Mexican peso crisis <i>Stephany Griffith-Jones</i>	155
<hr/>	
Recent ECLAC publications	177

Development thinking *and policies:* the way ahead

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This article takes a long-term view of the evolution of development thinking and policies in Latin America and the Caribbean. It begins by looking at the changes in policy formulation trends, noting that the most abrupt changes of this type occurred, first during the period between the wars, and second, in the early 1980s, and although in both cases changes took place which may be considered as swings of the pendulum or phases in a larger picture, they were nevertheless significant. The author then reviews the economic reforms implemented from the 1980s onwards and highlights their common factors, although these cannot be said to belong to a set paradigm, because of the markedly different ways they were applied in the different countries. He then points to some lessons that may be drawn from the economic and social results achieved, notably the insufficient level of equity obtained and the fact that while "correct" prices are very necessary, they are not of themselves sufficient to ensure development. He highlights the combination of orthodoxy and heterodoxy which has characterized the East Asian development experience, and finally details various implications which the present trends may have for the future of the region: especially the need to combine stable and coherent macroeconomic management with new forms of action at the microeconomic and mesoeconomic levels.

I

Introduction

Analysing the ways in which development thinking and policies have evolved over time in Latin America and the Caribbean, the effects that those policies have had in recent times, the lessons that can be learned from these events and –as if these questions were not already enough– the predictions that can be made regarding the course of development thinking and policies for the future is, to say the least, a tall order.

In the first place, there seems to be something of a Manichæan bias in the way development economics is approached in Latin America: the debate alternates between seemingly incompatible inward-led growth vs. export-led strategies; *laissez-faire* vs. *dirigisme*; structuralism vs. monetarism. In fact, reality defies such neat characterizations: rather than being able to settle on a single paradigm, the issues usually cover a whole spectrum of policies and strategies.

The same may be said of trying to establish cause-and-effect relationships. At times, economic performance is perceived in terms of factors originating exclusively in the international economy; conversely, in other cases the analysis is narrowed down to the results of domestic policy-making. The real world, of course, is more complicated, and the characteristics of policy-making as well as cause-and-effect relationships must inevitably be presented in different shades of gray, rather than in black or white.

Secondly, we must not leave out the usual caveat: Latin America is made up of many widely differing countries. Neither the modalities of the 1950s nor those of the 1980s were applied uniformly: some countries embraced each model earlier –and more fervently– than others, and marked differences in policy-making are to be seen as regards the pacing, sequencing, and mixing of different measures. Furthermore, similar policies in different countries have led to disparate results, precisely because each context is different. It is always risky, therefore, to try to draw universal conclusions from the enormous variety of experiences that the region has to offer.

In spite of these reservations, I have made an effort to stick to the broad questions noted earlier, with the aim of helping to highlight some issues and introduce some parameters that may clarify the debate regarding differences in economic and social policy-making over time within Latin America, and also in comparison with other developing regions. I have accordingly divided my presentation into five necessarily brief parts. The first of these (section II) examines the shifts in policy-making over time; section III concentrates on the economic reforms put in place since the 1980s; section IV tries to garner some lessons from the economic and social performance observed to date, in so far as it is linked to the reforms; section V briefly compares the East Asian and Latin American experience, and the final section (section VI) probes the future.

II

Trends and shifts in policy-making

It appears that economic thinking is subject to something akin to the cycles that affect economic performance. The equivalent of the Kondratieff waves –the

long cycles– reflects the theoretical trends prevailing at a given time regarding the related issues of the economic role of Government (from Adam Smith's *The Wealth of Nations* to Keynes's *The end of Laissez-Faire*) and the degree of "openness" to international trade. The shorter cycles are presumably shaped by excesses in the application of the policy

□ This article embodies the main elements of the author's presentation at the Conference on Development Thinking and Practice (Washington, D.C., 3-5 September 1996) organized by the Inter-American Development Bank (IDB).

actions that arise from the world of ideas. In other words, ideas shape action, and action then retro-shapes ideas.

In the case of Latin America, the region certainly has experienced these cycles over the past 80 years or so, both in the realm of economic thinking and in the domain of economic action. There have been at least two abrupt shifts: the first between the inter-war period and the post-war period, in response to the Great Depression and the effects of the Second World War; the second in the 1980s, in response to the debt crisis and globalization (some authors would identify a third shift in the mid-1970s, at least in the Southern Cone, but more on that later). In each case there was ongoing evolution, both conceptually and in practice.

This continuous change, which some like to view as a pendular movement but others describe as "stages" (Birdsall and Lozada, 1996), reflects a combination of universal trends and more parochial responses to both external shocks and domestic events. Further, when examining these dynamics it is hard to discern whether economic thinking and policy actions preceded economic performance, or whether economic thinking was rather shaped by economic realities; in fact, of course, both phenomena are going on simultaneously.

The first major shift in question took place in the 1930s and 1940s: a period in which the majority of the countries of the region abandoned orthodoxy and embraced industrialization based on import substitution, with its attendant interventionist policies. The economic realities that drove this change stemmed from the 1930s crisis, as countries started to tackle the deep depression and attendant foreign exchange constraints by restricting imports and promoting domestic alternatives. Even when the foreign exchange shortage was alleviated thanks to the accumulation of reserves during the Second World War the difficulty of obtaining manufactured goods on international markets kept import substitution in place, especially in the larger countries.

As is well known, the conceptual framework for this trend came, at least in part, from the Economic Commission for Latin America, led by Raúl Prebisch, which developed a persuasive argument in favor of industrialization and a strong State presence, based on the asymmetrical relations between the "centre" and the "periphery" (ECLAC, 1951). This

theory emphasized the structural impediments to development: i.e., it was almost the antithesis of the "magic of the market". The time-frame of the approach was medium and long term; little importance was attached to short-term economic policy-making, especially in the sphere of monetary, exchange and fiscal policy.

Although Prebisch himself warned of the dangers of excessive protection, over the years the ECLAC "message" became rather stereotyped and was accused of being excessively inward-oriented and *dirigiste*. Indeed, powerful pressure groups developed in the region (exemplified by the Chambers of Industry and trade unions) which were in favour of keeping protection in place and even enhancing it, thus generating a self-perpetuating dynamic which other pressure groups (exemplified by the Chambers of Commerce and of Agriculture) were unable to mitigate. It may therefore be argued that the import substitution strategy was maintained much longer than circumstances warranted. Furthermore, the region's economic performance in the 1950s and 1960s, at least in terms of growth, was more than respectable: average real per capita GDP nearly doubled between 1950 and 1970.

It is thus not surprising that the voices of opposition to ECLAC's approach during the 1950s—which came from Latin American academic circles (for notable examples, see Viner, 1953 and Corden, 1966) and also from the Bretton Woods institutions—were at first muted but then gathered momentum in the 1960s, giving rise to serious questioning from both sides of the ideological spectrum. The supporters of dependency theory (the *dependentistas*) implicitly called for more State intervention and less dependence on trade and capital flows, while the more conservative school of thought called for less State intervention and more orthodox economics. Furthermore, import substitution industrialization ran into trouble in the real world, given its anti-export, anti-rural biases and the fact that it was found that the model actually increased external vulnerability, rather than mitigating it.

At the same time, a shift in economic thinking was taking place in the world surrounding Latin America, and it naturally influenced the debate within the region. Although the question of "openness" to international trade was not at the centre of the debate, mainstream post-Keynesian economics was being attacked both from the conservative flank (the Chicago

School, with its libertarianism) and the progressive one (the so-called radical economists). Even so, the "inward-looking" model remained in being in Latin America for the next decade or so, thanks to: i) the expansion of domestic markets through formal economic integration arrangements; ii) mitigation of the anti-export bias of policy-making through selective policies (especially fiscal incentives) designed to promote non-traditional exports, and iii) greater access to international financing, especially from public sources in the 1960s and private ones in the 1970s.

The most abrupt reversal of this situation took place in the mid-1970s, and it was limited at first to the Southern Cone countries (Argentina, Chile and Uruguay). All three of these nations suffered severe macroeconomic disequilibria and price distortions; all were ruled by authoritarian military regimes, and all of them returned to what one author calls "neo-conservative economics" (Ramos, 1986) and another labels "international monetarism" (Fishlow, 1985). As Fishlow points out, "the objective of the initial application was to reduce domestic inflation. The way to do so was by a pre-specified, decreasing adjustment of the exchange rate, using the law of one price. The way to keep inflation down, once it had fallen, was by a fixed exchange rate. Free trade and capital movements would both facilitate stabilization and guarantee development" (p. 135).

Other features of the Southern Cone approach, however, were harbingers of things to come in the 1980s (Corbo, 1988): liberalization of trade and of domestic financial markets, opening up to international capital flows, deregulation, reduction of the fiscal deficit (less in Argentina than in the other countries), and restrictive monetary policies. In general, free prices were restored as the central mechanism for the efficient allocation of resources, although as Albert Fishlow correctly points out, "international monetarism did not work as advertised," owing to three important limitations: "application to the short-term of long-run equilibrium conditions; inadequate attention to the components of the balance of payments and concern only for a bottom-line total; and a focus on macro-economic equilibrium rather than on economic development" (pp. 136-137). In effect, overvalued exchange rates and excessive short-term capital inflows, as well as insufficient at-

tention to the supply side of the economies, led to a profound recession and an insolvent banking system.

All this represented a crucial break with the past strategy of all three countries; according to Fishlow, correcting the obvious flaws of the new approach meant building on some of the new foundations, rather than returning to the old ones (although there was some tension between proponents of each of these options).¹ The debt crisis of 1982 led to a major shift in economic thinking and policy-making, not only through the force of circumstances, but also because the new and acute balance of payments crises highlighted the flaws and weaknesses of the previous strategy (its vulnerability to international crises, a tendency to price distortions and lack of international competitiveness), which had been gradually accumulating over the years.

At first, adjustment and stabilization were approached in a disorderly manner, and at an extremely high social cost. A curious mixture of controls and liberalization, of orthodox and heterodox approaches, can be found in the first half of the 1980s. Much was made of the "heterodox" adjustment programmes of Argentina, Brazil and Peru, which sought to control inflation without falling into recession by guiding expectations through price and income controls in the short run, combined with liberalization of markets in the medium term. Contrary to the Israeli experience during the same period, however, all of these programmes ultimately failed, although each one for somewhat different reasons (Bruno and others, 1988).² But there was also a learning process going on, and a gradual convergence on the main parameters of a new approach, which undoubtedly represents a return in the direction of greater orthodoxy.

¹ This tension was also reflected within the ECLAC Secretariat at the time, with proponents of both strategies engaged in a lively debate.

² Bolivia is also considered by some to be a successful example of heterodox stabilization. However, at the levels of inflation being experienced by Bolivia at the time (1985), orthodoxy and heterodoxy tend to merge in terms of policy responses (Morales and Sachs, 1988). A more contemporary effort at such a heterodox approach, but with greater fiscal control, was Brazil's *Plano Real*.

III

Recent reforms

The above-mentioned convergence may be observed in several key areas of policy-making, which display a conspicuous tendency towards trade liberalization, greater confidence in market forces as the prime allocator of resources, less "interventionist" public policies, and greater coherence in macroeconomic policy-making. In other words, just as the crisis of the 1930s gave rise to import substitution and greater public sector intervention, the crisis of the 1980s ushered in a move towards more open, market-oriented economies.

Some authors have interpreted this shift in economic thinking as the emergence of a new paradigm, which the Latin American media often call "neoliberal". More modestly, some years ago John Williamson referred to this framework of policy-making as "the Washington Consensus" (although it was not conceived in Washington and does not reflect a consensus; John Williamson himself tells us he has come to regret the term). This approach is reflected in some key reforms affecting policies and markets, and pursues the twin objectives of macroeconomic stabilization and the development of international competitiveness.

More specifically, despite differences of degree and emphasis, the elements common to the approach include the following: i) explicit measures to liberalize trade, characterized by the elimination of quantitative restrictions and the establishment of moderate tariffs and narrow spreads (or, even better, a uniform low tariff); ii) fiscal discipline (reduction of the fiscal deficit or even achievement of a surplus), along with the redirecting and prioritization of public expenditures; iii) tax reform (broadening of the tax base, improvement of administrative procedures, abolition of special exemptions); iv) monetary discipline, including moderate but positive real interest rates; v) financial liberalization, with gradual abolition of preferential interest rates for privileged borrowers; vi) privatization of most State enterprises and deregulation to eliminate all regulations that restrict com-

petition (except in the case of natural monopolies or other exceptional situations); vii) deregulation of the financial and labour markets; viii) elimination of barriers to the entry of direct foreign investment, and ix) a legal and institutional framework that strengthens property rights (Williamson, 1990).

More recently, some observers mention a "second generation" of reforms, which include the creation of independent central banks, the imposition of budgetary constraints on State, provincial and local governments; establishment of a modern and effective national civil service; improvement of citizen's security, and reform of the judiciary (Edwards, 1996).

Just as important as the above characterization, however, is what the approach does *not* include: the overwhelming importance attached to market signals as the basis for resource allocation resulted in the virtual disappearance of selective incentives, investment promotion schemes and, above all, industrial policy measures. Indeed, some would argue that the approach is a stabilization tool, not a development strategy. At all events, not only did policymakers dwell on short-term policy-making, but they implicitly accepted the notion that firms would somehow adapt to the new regulatory framework and to macroeconomic incentives, eventually acquiring international competitiveness through the "magic of the market".

Furthermore, this characterization can hardly be described as a paradigm, for there are marked differences in the manner in which each country approaches the practical application of the different elements, their specific content, and the pace, scope and sequence of their implementation and the overall mix of policies used (the "menu").

Three eloquent examples can be cited. First, in the realm of exchange rate policies, where although all the countries share the goals of unifying their exchange rates and keeping them stable and competitive, they have adopted differing approaches, which vary from a relatively free floating exchange rate

(within limits), a "dirty" float, and a pre-fixed and controlled float, to a fixed exchange rate.³ Second, in the various features of the region's anti-inflation programmes, which vary mainly with regard to the pace of implementation, and whether the conventional monetary and fiscal restrictions are accompanied by price and income policies designed to influence the expectations of economic agents. Thus, one finds gradual programmes, accompanied by price indexing, but also radical shock programmes. The third example is to be found in the liberalization of the capital account: a process that in some countries is applied simultaneously with the liberalization of the current account, while in others it is applied sequentially (Ffrench-Davis, Titelman and Uthoff, 1994).

Among the many other areas of differentiation to be found in policy-making, the following can be mentioned: i) actions designed to counteract the regressive effects of economic policy (targeting of public expenditure, transfers); ii) actions aimed at promoting specific productive activities; iii) the political will to privatize public enterprises, especially those engaged in the exploitation of mineral resources for export (oil in Mexico, copper in Chile); iv) the means used to regulate monopolies of privatized public services; v) adaptation of the legal and institutional framework governing property rights; vi) adoption of legal norms consistent with the goal of fiscal and monetary discipline; vii) incorporation of the goals of social equity and allocative efficiency into tax reform processes; viii) the content and scope of social security, welfare and labour law reforms; and ix) in general, the relative contribution of the public sector to the gross domestic product, which varies from as little as 10% to as much as 30% between the different countries.

³ But in no country has the market been allowed to freely set the exchange rate without selective interventions on the part of the Central Bank, even where future markets for the corresponding currency exist.

These distinguishing characteristics, combined with the different political outlooks of the governing teams, the changing traits of the political systems, and the different degrees of economic and technological maturity of the productive systems in the various countries, explain not only the varying pace and content of the reforms, but also the differing results achieved.

In short, the most significant institutional reforms carried out by most countries of the region represent a major shift in policy-making and in the level and scope of State intervention in the economy. This change accelerated and shaped the transformation of the development pattern that was already on the horizon prior to the debt crisis. The shift includes a move from import substitution and public investment towards exports and private investment as the main engines of growth. However, the manner in which this general thrust has been implemented has varied greatly from one country to another.

The last aspect of policy-making in the 1980s to which I should like to refer concerns formal economic integration arrangements. As is well known, several free trade or common market agreements were signed in the 1950s and 1960s. These were all highly functional to import-substitution industrialization, and when the latter strategy came under attack so too did the integration agreements. During the first half of the 1980s, these agreements virtually disappeared from the regional scene, only to be reborn a few years later in a new guise: a second generation of agreements, more compatible with export-oriented strategies, which are the types of agreement that have been adopted in the last ten years or so. This form of "open regionalism" (ECLAC, 1994) gained momentum in the 1990s and has even opened up the possibility of hemispheric integration with the signing of the North American Free Trade Agreement between Canada, Mexico and the United States, and the subsequent commitment assumed by the Heads of State and Government to create a "Free Trade Area of the Americas" beginning in the year 2005.

IV

Some lessons from the recent reforms

Which major economic and social problems have been successfully tackled by the policies of the 1980s, and what lessons have we learned? Despite the difficulty of establishing causal relationships between ideas and action, between policies and performance, there are indeed some salient characteristics of the 1990s, and some lessons to be learned (ECLAC, 1996a and 1996b).

With regard to the results obtained, the shift to a more market-oriented approach and the greater coherence and stability shown in macroeconomic management, especially in the fiscal and monetary spheres, have undoubtedly played a major role in bringing inflation under control. During the second half of the 1980s, several countries (Argentina, Bolivia, Brazil, Peru, Nicaragua) were afflicted with hyperinflation; indeed, the weighted average yearly inflation for the region was of the order of 1,000% in 1988, 1989 and 1990. By 1995, however, the weighted average yearly inflation was 25%, and about half of the countries had either reached single-digit inflation or were close to achieving it. There can be no doubt that this progress is due to the stabilization policies which affected both the expectations of economic agents and aggregate demand.

Moreover, by the early 1990s most of the countries of the region had recovered the capacity to grow, albeit at moderate rates. Some countries grew rapidly for one or two years, but then faced the need to adjust; only Chile has been able to sustain high growth rates for an extended period of time. The fact that growth was not more dynamic partly reflects the trade-offs between policies designed to maintain stability and those aimed at promoting growth: an issue that continues to elicit a lively debate (Dornbusch and Werner, 1994).

Another expression of possible trade-offs between growth and stability is what happened in the external sector, as the region moved from current account surpluses to growing deficits. The pattern of moderate growth with increasing price stability was aided, from 1991 onwards, by a heavy inflow of international capital attracted partly by high interest rates and partly by the confidence inspired by improved macroeconomic management, progress in struc-

tural reforms and the consolidation of democratic political regimes. This is quite a notable achievement when one recalls the long period of net financial outflows that characterized the region only a few years ago.

The magnitude of capital inflows in the period 1993-1994 was such that, in many countries, they contributed to exchange rate appreciation and obliged the monetary authorities to push interest rates even higher. This syndrome, combined with faulty domestic policies, was one of the underlying causes of the Mexican financial crisis of December 1994 (Sachs, Tornell and Velasco, 1995), and was a reminder to policy makers that the maintenance of macroeconomic equilibria is an ongoing challenge. In other words, the conditions under which the economies are evolving leave them vulnerable. In many cases, macroeconomic stability has been achieved at the cost of large balance-of-payments current account deficits, financed at times with volatile capital likely to withdraw at the first sight of any circumstance that dampens investor confidence.

To make matters worse, the considerable level of external saving was not being channeled to increased investment: instead, a significant proportion was fuelling the consumption of imported goods. The ratio of national saving to GDP had been growing very sluggishly, and the total investment/GDP ratio is far below the levels obtaining before the debt crisis. In the specific case of Mexico, for example, while external saving increased from 3.6% to 7.0% of GDP between 1990-1991 and 1993-1994, national saving decreased from 18.5% to 15.6% over the same period (ECLAC, 1996b, p. 53).

Another manifestation of the continued vulnerability, in spite of the progress achieved, is to be found in two structural dimensions. One is the weakness of the financial systems in some countries, frequently compounded by the shortcomings of the regulatory agencies: a number of financial crises affecting large banking institutions have required rescue operations at a high fiscal cost. The second dimension refers to fiscal stability, since the progress achieved so far has proved to rest on somewhat fragile foundations: in

both Argentina and Mexico, the economic contraction of 1995 was accompanied by a disproportionate fall in fiscal revenues, forcing both Governments to raise tax rates.

But perhaps the most glaring insufficiency of economic performance in the past few years—related, to be sure, to modest growth rates—has been in the realm of equity. Although the incidence of poverty has gradually fallen in most countries, the levels are still considerably higher than those observed in 1980, while income distribution has worsened in virtually all cases (Uruguay seems to be the main exception),⁴ except where there has been a rapid decline in inflation (Brazil in 1994-1995). The relatively poor results obtained in terms of equity (ECLAC, 1995) can be traced to three phenomena.

In the first place, the type of productive restructuring that resulted from the adjustments, the shifts in relative prices and the liberalization of trade have so far failed to generate enough job opportunities to absorb new entrants into the economically active population. In the current phase of moderate growth, the number of productive job opportunities has increased very slowly, while the wage differential between jobs requiring different levels of training has tended to widen.

In the second place, the public policies adopted so far in order to alleviate the most serious manifestations of deprivation and marginalization have not had sufficient resources to achieve their aims, and they have been of only limited efficacy; social spending has been constrained by efforts at budgetary discipline, and social policy management has not progressed with the necessary speed and effectiveness.

Lastly, although the final verdict is far from definitive, and there is considerable debate going on regarding this matter (Scobie, 1990; Taylor, 1988), there are indications that—except in countries which drastically reduced their inflation rates—policy-making has had a regressive bias, given the initial effects of the adjustment on real wages, real interest rates, levels of employment and public expenditure.

The worsening patterns of equity have been even more noticeable at the microeconomic level, where

the processes of adjustment, macroeconomic stabilization and structural reform have acted as a powerful selection mechanism which has forced firms to adapt to the new scenarios governed by price signals and the new patterns of regulation of productive activities. It is not surprising, then, that different firms have had very varied reactions to these phenomena, depending on their type of activity, the region of the country where they are located and the system of production involved. In general, the sectors hardest hit by the changes in the rules of the game and the regulatory framework have been industries that produce for the domestic market, activities that involve relatively intensive use of engineering services, small and medium-sized firms and State enterprises in general. In contrast, sectors involved in exporting, activities based on natural resources, large domestically-owned conglomerates and many transnational corporations have been able to adapt more successfully to the changing circumstances.

Restructuring has forced the region's productive systems to revert to their traditional areas of comparative advantage (basic and industrial commodities), although in a number of cases they have been able to incorporate new technologies that have expanded access to available natural resources and modernized the methods of their exploitation. The structural heterogeneity characteristic of the region's productive systems has been accentuated, as productivity differences have tended to widen between large, world-class firms in the forefront of the modernization process and the many and varied activities that are lagging behind. This trend has been further reinforced owing to the segmentation of credit, which has practically excluded small and medium-sized firms from access to the main sources of capital. Another reflection of this phenomenon is the rapid disappearance of traditional shops due to the appearance of large American-type shopping malls run by domestic or international conglomerates. The net result has been that while both total factor productivity and labour productivity have risen rapidly in the "modern" sectors, they have been going down in the less advanced sectors, thus partly offsetting the progress made by the economy as a whole.

In short, the changes in the field of policy-making in the 1980s have not been accompanied by a really satisfactory improvement in economic performance, although it cannot be denied that substantial progress has been made compared with the disastrous

⁴ It is tempting to surmise that the reason why Uruguay has been an exception in this respect is due partly to the fact that it has not dismantled the generous social security system inherited from the Welfare State, whose continued existence is in direct contradiction to the trends of recent decades.

preceding decade. Furthermore, in theory the reform process should leave the countries much better fitted than before to cope with the challenges of globalization. However, the progress actually made possible by this process has been neither solid enough nor far-reaching enough to achieve sustained growth, financial stability and greater equity. At all events, the experience gained is helping to develop ideas and formulate policies at the economic level.

Among the most important lessons learned from this process, two linked ideas stand out. Firstly, there is the idea that a stable macroeconomic environment is an essential precondition for stimulating saving and investment and achieving higher rates of growth. In order to match effective demand with the production frontier and to cushion the effects of external shocks, the countries need mutually consistent monetary, credit, fiscal and trade policies, though these will naturally differ from one another in terms of their scope and content. They also need suitable income and wage policies, combined with policies to promote saving, investment and the development of production capacity.

However, and in the second place, excessive reliance on the "automatic" effectiveness of price sig-

nals and macroeconomic reforms has led to a tendency to underestimate the weakness of institutions, flaws in the markets (many of which are imperfect, segmented or incomplete) and the importance of externalities, and has on occasion induced overconfidence in the capacity of macroeconomic policy alone to trigger growth. Experience has shown that even the best-conceived policies can prove ineffective or fail to produce the desired effects in an adverse institutional context. The fact is that these structural problems make it difficult to achieve sustained growth solely on the basis of price signals.

Thus, the most important lesson derived from the reform process is that what is needed is *a return to orthodoxy in some respects* (an interest in ensuring that prices are "right"), *combined with a rejection of orthodoxy in other respects* (the "right" prices are necessary, but not enough in themselves). Once we recognize the interactions that exist between stabilization measures and structural reforms, it may be that the integrated consideration of macroeconomic scenarios, institutions and regulatory frameworks, factor markets and microeconomic behaviour will become a more important feature of policy-making in the future.

V

An aside: the East Asian development experience and its effects on Latin America

As an aside, it may be worth recalling that already in the 1980s the newly industrialized East Asian countries (Singapore, South Korea and Taiwan, together with Hong Kong) attracted much attention in Latin America as "success stories" that offered important lessons for the region (Fajnzylber, 1981). Indeed, both the proponents of export-oriented strategies and of strong State intervention could find models worthy of imitation in those countries. This explains the many studies prepared in recent years in order to draw practical conclusions from the success of the so-called "high-performing Asian economies", the best known of which is undoubtedly "The East Asian Miracle" (World Bank, 1993).

There are, of course, differing interpretations of the lessons to be learned from the success of the Asian economies, especially in the areas of how important their export and market orientation, or the industrial policies followed, really have been (Fishlow and others, 1994). In addition, the obsession with the "Asian tigers", and especially Korea, has probably been somewhat misdirected, given the important cultural, political, institutional and economic differences among these countries and especially between them and the Latin American nations. It should further be recalled that the shift from import substitution to export orientation in these particular countries occurred before globalization greatly reduced the

leeway for policy-making, because the world is now less tolerant than it was in those days regarding the use of gradual or selective trade liberalization mechanisms.

Still, there is much to be learned from the Asian development experience of past decades,⁵ especially in the case of the South-East Asian countries (Indonesia, Malaysia, the Philippines and Thailand), which share many common features with a number of Latin American countries, and there is clearly potential for enhanced interregional cooperation and the exchange of experience. In fact, some of the elements generally seen as accounting for the success of the high-performing Asian economies are being systematically applied in Latin America. They include the pursuit of macroeconomic stability (or, in the words of the World Bank, "getting the basics right"), recognition of the need for greater investment in human capital (although the region's efforts do not

yet match those observed in East Asia), and acknowledgement of the need to increase domestic financial saving and adopt greater export orientation. In addition, the proponents of giving industrial policy a more central role in promoting development in Latin America draw on numerous East Asian countries as their source of inspiration.

Just as in our own region, a mix of orthodoxy and heterodoxy is also plainly present in the East Asian economies. In the words of the World Bank, "fundamentally sound development policy was a major ingredient in achieving growth...but these fundamental policies do not tell the entire story. In most of these economies, in one form or another, the government intervened—systematically and through multiple channels—to foster development, and in some cases the development of specific industries". (World Bank, 1993, p. 5)

VI

Future implications of current trends

From my earlier comments it may be deduced that I am suggesting that the pendulum of development thinking has reached its furthest point in the direction of orthodoxy, and is now gradually coming back. Whether we are on the brink of a major shift comparable to the two major transformations referred to earlier or, as seems more probable, a more moderate adjustment of the prevailing trends remains to be seen. There can be no doubt, however, that the set of foreseeable changes will have far-reaching repercussions in terms of the form of growth, so that the development of the region in the second half of the 1990s will be markedly different from that observed in the first half of the decade.

What will these adjustments be like, and how will they affect future trends in economic thinking and development policies? I should now like to outline some possibilities in this respect, drawing on some of my previous points, while avoiding covering

the territory that Albert Fishlow will probably examine in his paper on "Implications and Development Perspectives for Latin America and the Caribbean".

The first idea I would like to retrieve concerns the notion that economic thinking runs in cycles. There is little reason to believe that the clear shift towards market-based reforms will evolve towards some immutable paradigm. On the contrary, some of the shortcomings of economic performance which are rightly or wrongly attributed to the implementation of market-based policies alone have already given rise to some revisionism, or at least to questioning of the current conventional wisdom, especially in respect of whether it would not be a serious exaggeration to expect that "right" prices, by themselves, would lead to sustainable growth with financial stability and ever-improving equity.

This is not to suggest a return to outmoded policies of the past, which would be incompatible with the way the international economy functions today. What I really mean to say is that it is reasonable to assume that globalization will dictate certain norms of international behaviour as regards macro-economic policy-making, and this will probably be

⁵ But this cannot be viewed as a "model": in his foreword to the 1993 World Bank study, Lewis Preston, then President of the Bank, rightly points out that "The eight economies studied used very different combinations of policies, from hands-off to highly interventionist."

all to the good, since continuity (in contrast with wild swings in policy-making) is valued as part of the image of stability that countries need to project in order to compete for international resources and markets. What is most likely to take place, however, is that first there will be a shift from emphasis on short-term macroeconomic management to medium-term development strategies, after which there may be a redefinition of the role of public policy in meeting key development objectives, such as improved productivity (at the company as well as the systemic level), environmental sustainability and improved income distribution. In short, perhaps we can look forward to that combination of orthodoxy and heterodoxy I mentioned earlier: that is to say, a combination of stable and coherent macroeconomic management with a new form of intervention at the micro- and meso-economic levels. This approach, which some authors have termed "neo-structuralism" (Fishlow, 1985; Sunkel, 1991), is fully in keeping, in general terms, with the proposals that ECLAC has been making since 1990 in its major publications.

Thus, the direction and content of policy-making in general will change once they are placed in a more clearly medium-term context. As already noted, the objective of maintaining the macroeconomic equilibrium will not be abandoned, but greater efforts will probably be made to ensure that the process of achieving stability does not distort the efficient allocation of resources required to raise the level of productivity. Macroeconomic stability is not just the maintenance of low inflation and fiscal balance but also a sustainable current account deficit, a level of domestic saving sufficient to sustain investment, a suitable real exchange rate, and a level of aggregate demand consistent with full utilization of existing production capacity. Policy makers will presumably strive for progress on all fronts at the same time, without overemphasis on any one of these goals at the expense of the others.

Firstly, the relative orthodoxy that will mark macroeconomic management will most likely be complemented with a more "activist" stance on the part of governments. This activism will be manifested in more selective policy interventions at the macroeconomic level in order to meet specific objectives of development, such as attaining international competitiveness, maintaining price stability and achieving greater social equity. In other words, public policy will not be limited to maintaining overall

macroeconomic consistency but will also place greater emphasis on production development policies. These might include, for example, supporting information networks, strengthening the mechanisms of business cooperation, protecting intellectual property, promoting research centres and extension services for the technology specific to a given sector, adopting international norms and standards, and promoting occupational training and education.

In the same vein, we can look forward to greater government intervention to mobilize national saving and channel it towards productive investment. Relying solely on the market and interest rates has not led to appropriate saving/GDP ratios and it has also hindered the attainment of better investment/GDP ratios. To attain adequate levels of saving and investment, stable macroeconomic management will need to be complemented by effective incentives and appropriate institutions. We can expect greater efforts to promote institutional saving (through reforms in the pension and tax incentive systems), to improve and deepen financial systems, to develop well-regulated and supervised financial institutions and instruments, and to help previously excluded branches of activity to gain access to investment capital.

Secondly, the clear shift that has taken place in the last decade towards greater specialization in the export of industrial and even basic commodities is a two-edged sword. On the one hand, it makes sense for the region to base its growth on the exploitation of its generous endowment of natural resources, especially since the application of technological innovations has in general improved the international competitiveness of most of these goods, so that the region has better access to the respective markets. On the other hand, however, this specialization has some similarities to the international division of labour as perceived by ECLA as far back as 1949; it would be an irony if we came back to where we started and accepted that, in the global economy, the developing countries (or at least the Latin American and Caribbean countries) should specialize in commodities subject to low demand elasticity on world markets, thus restricting us to low-productivity sectors. One of the main objectives of what we call "changing production patterns" is to move in the direction of economic activities with a higher value added and a higher growth potential: i.e., activities offering dynamic comparative advantages. Thus, the selective policy interventions alluded to earlier will probably

be aimed at developing clusters of activities around the industrial commodities that are currently among Latin America's strong points,⁶ establishing both forward and backward linkages designed to permit the production of goods with a higher degree of processing and value added.

Thirdly—to return to a point that was only briefly touched upon in my earlier comments—environmental issues will loom ever larger on the Latin American policy agenda in the years ahead. This is because growth will very probably depend to a large extent on the efficient and environmentally rational exploitation and processing of natural resources (ECLAC, 1991). Furthermore, it is already clear that the link between environmental standards and trade will become an increasingly important issue in international economic relations, and it is preferable for the countries of the region to adopt an offensive strategy rather than expose themselves to a new form of protectionism. Partly because of the impact of the 1992 United Nations Conference on Environment and Development, the old dilemma between growth and environmental protection has been practically left behind: it is now increasingly acknowledged that these two factors are not necessarily incompatible and can even be mutually supportive.

Fourthly, another aspect of policy-making which will be assuming increasing importance in the next few years will be the need to try to reconcile unilateral trade liberalization measures with formal intra-regional and even intra-hemispheric trade agreements. It is interesting to note that the boost given to regional cooperation in recent years has not adversely affected most countries' commitment to participate in the process of world trade liberalization, which has given relatively good results. However, just as regionalism can help to create a more open international economy, it can also contribute to the breaking up of the world or regional economy into blocs. Hypothetically, the new generation of trade agreements could give rise to a wide variety of situations, ranging from a region fractured into four or five subregional groupings to a hemisphere-wide free trade area. It is too early to forecast what will finally happen, though it is to be hoped that the latter possibility will prevail. At any rate, this topic will

certainly occupy an important place on the region's development agenda for the rest of this decade, and probably many years more.

Fifthly, there can be no doubt that the most important task left over from the post-war period in Latin America is that of improving equity. Given the increasing disparities between the different segments of the population, and their impact on political interaction in more pluralistic societies, this problem will surely have to be tackled more systematically. The generation of more jobs will become one of the most important public policy objectives, and this means that it will be necessary not only to achieve a better investment/GDP ratio and higher growth rates, but also to provide incentives for activities which are labour-intensive yet competitive and to promote higher productivity in general. It is also very likely that greater resources will need to be assigned to health services and, above all, education. The issue of participatory development, which has aroused more interest in Asia than in Latin America, will surely be taken up again (Ghai, 1988; Schneider, 1995). In addition, increasing importance will be given to improved means of implementing social policies, including the targetting of expenditure towards the most vulnerable segments of the population. It is even possible that, at least in some cases, there will be a revival of the old debate on the possible justification for agrarian reform, which had practically disappeared from the development agenda until recently, although it is once again in the limelight in Brazil.

Inequity has undoubtedly always been a characteristic feature of Latin American development. There are some reasons for guarded optimism that real progress can be achieved on this front, however, especially if higher growth rates are attained. These reasons are the following. First, population growth rates are declining quite substantially, and the impact of this trend on the demand for public services and on the number of entrants into the workforce will be felt in the coming years. Second, the increasing attention most countries have been giving in recent years to the quantitative and qualitative aspects of education, and the heavy investment in human capital to ensure that workers' skills keep pace with technical progress, should start to yield tangible benefits by the early years of the next century. Third, the extraordinary expansion in grassroots organizations in recent years, combined with the consolidation of democratic

⁶ Products deriving from the fishery, forestry, mining, petroleum, energy and agricultural sectors.

and participative political systems, should diversify the structure of pressure groups, currently dominated by big business.

Finally, although few in our region are in favour of a return to authoritarian government intervention or the reappearance of privileged sectors of production, the public policy agenda will clearly be broad, complex and demanding. In order for the trend towards democratization to receive all the attention it deserves, public sector reform must occupy a leading place on the development agenda, with the sole objective of providing governments with greater capacity to carry out their duties more effectively and hopefully with greater openness and responsibility than in the past. This will put an end to the debate on this subject, and orthodox approaches will continue to have supporters who mistrust *all* public intervention on principle. If we are to remain true to the idea that economic thinking moves in cycles, we should acknowledge that this may be the beginning of a new trend in policies that may bring us, possibly around the year 2020, to a situation of greater orthodoxy.

To conclude on a rather optimistic note, we might say that if these trends in development thinking and policy-making continue, most Latin American countries can look forward to improved performance in the years to come, in terms of both growth and equity. In other words, the learning pro-

cess of the 1980s and 1990s can prove to be a valuable contribution to development as the region enters the next millennium. The pragmatism currently observed in policy-making should be an important asset in this endeavour. The same can be said for the increasing creativity and entrepreneurial spirit that the region's private sector has shown in recent years. Likewise, the consolidation of economic interdependence within the region, led by a new generation of formal integration agreements, will reduce the region's vulnerability to external shocks. By the year 2000, Latin America and the Caribbean will have a population of 515 million inhabitants with middle-level per capita incomes (an average of around US\$ 3,800), and this will make it an attractive market in its own right.

To be sure, progress will not be linear, nor will it be evenly distributed, whether between countries, subnational regions, or different strata of the population. Furthermore, it will be a long time before it will be possible to put right many of the problems currently faced by the region which seem to be insoluble – urban sprawl, lack of personal security, environmental degradation, widespread poverty and deterioration of the physical infrastructure. Still, no-one can deny that on balance we are moving in the right direction.

(Original: Spanish)

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