

KEYWORDS

Financial crisis
Economic development
Development strategies
Sustainable development
Macroeconomics
Investments
Productivity
Income distribution
Social policy
Latin America
Caribbean region

Structural constraints on development in Latin America and the Caribbean: a post-crisis reflection

Alicia Bárcena

The development of Latin America and the Caribbean is still a work in progress. Although there have been macroeconomic improvements, allowing the region to confront the recent crisis on a better footing, this crisis has exposed old and new structural constraints faced by the countries of the region, which are reflected in the persistence of large social, economic, fiscal and environmental gaps. These gaps need to be closed for the sake of future generations and as a precondition for viable development that combines economic growth with equality and sustainability. This suggests that there are more than just economic reasons for the State to play, once again, a major role in development strategies, so that public policies take the lead in building the future. The main purpose of the present article is to make this argument.

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I

Introduction

ECLAC has put forward three general hypotheses about the character and consequences of the recent crisis. The first is that it is not just a manifestation of weaknesses in financial system regulations, or the exclusive result of a moral crisis brought on by ambition and greed. The crisis is also bringing a particular “development style” to an end and opening up new avenues for economic, social and environmental debate.

The second hypothesis is that the State needs to play a renewed part in guiding development strategies in the region’s countries. Setting out from a critical review of its recent performance, there is a vital need to redefine the role of the State and the way it operates, with a view to achieving a balanced interaction between the market, institutions and citizens in the development process.

The third hypothesis, which follows naturally from the first two, is that there needs to be a return to the idea of building “long-term” development strategies. This will require a greater capacity to devise and implement public policy measures that can reconcile what is enduringly important with the needs of the moment.

For all the progress in the past decade, the economic and social development of Latin America and the Caribbean is still a work in progress. There have been major macroeconomic advances that have translated into an improved fiscal situation, lower inflation and lower levels of external debt, all of which put the countries on a better footing to deal with the global economic and financial crisis that began in 2008. At the same time, however, successive financial shocks since the 1990s have resulted in more volatile business cycles and an unsatisfactory growth pattern. Old problems like the dynamics of productivity, economic heterogeneity and the creation and dissemination of technological capabilities still persist and underlie some of the structural constraints affecting the region. Thus, while the recent crisis has shown how important it is to strengthen the countercyclical capacity of macroeconomic policies, it has also reminded us of the need to prioritize production policies while

expanding the coverage and improving the design of social policies. This confirms the need to rebuild the capabilities that will allow the State to resume strategic planning of long-term policies, create more leeway for fiscal policy and design appropriate instruments to deal with the structural challenges affecting the current pattern of development in the region.

This article offers a reflection on State policies and action in Latin America and the Caribbean. It advocates new forms of policy intervention and management, without which there can be no progress towards the different goals of development combining growth with equality and sustainability. At the same time, it argues for a new debate and for the centrality of politics when it comes to redefining the roles of the State and the market, so that the requirements of development can be reconciled with the expansion of citizen rights and democratic institutions.

This article is structured as follows. Section II briefly reviews the macroeconomic performance of Latin America and the Caribbean, discussing how this relates to external dependency and the structural problems that have traditionally afflicted the region. Section III supplements the analysis by discussing the accompanying social trends in the region. Transmission mechanisms and the effects of the crisis on the region are analysed in section IV, as are the responses of the Latin American and Caribbean countries. Section V presents the post-crisis scenario and discusses the old and new structural problems already brought out in the tradition of ECLAC thought. These are reflected by the persistence of major divides in society (poverty, exclusion and unequal distribution of income), in the productive realm (investment, productivity and innovation), in the fiscal area (the level and efficiency of fiscal expenditure and tax collection) and in the environmental arena (low-carbon production and energy efficiency). It is argued that the last of these is not just a condition of viability for growth and the welfare of future generations, but also and increasingly a requirement of the international “new normal” now taking shape, an emerging characteristic which will constrain the carbon content of goods. These constraints will have substantial repercussions on the international trade and global role of Latin America and the Caribbean in the post-crisis world.

□ The author is grateful for the assistance of Mario Cimoli, Filipa Correia and Daniel Titelman, and for the contributions of Osvaldo Kacef, Joseluis Samaniego and Luis Yáñez.

II

Stylized facts regarding macroeconomic performance

Macroeconomically, the region has been characterized by low and volatile growth, particularly since the 1980s, and the result has been a persistently wide gap in per capita gross domestic product (GDP) between Latin America and the Caribbean and the developed countries.

GDP growth fell from about 6% in the 1970s to 2% in the 1980s (the “lost decade”) and some 3% in the 1990s. The “lost decade” was characterized by low rates of growth and investment, partly owing to the tremendous effort required to pay down the debt taken on in the 1970s. This was compounded by acute macroeconomic instability with very high levels of inflation that spilled over into hyperinflationary episodes in some countries, severely unbalancing the economy and aggravating the problems of poverty and inequality. Where economic policy was concerned, the primary goal was to reduce inflation, and short-term concerns predominated as a result (ECLAC, 2002). During the 1980s, furthermore, not only did the region have to cope with a sharp fall in its GDP growth rate, but social conditions deteriorated and it fell far behind a rapidly moving technology frontier. Latin America and the Caribbean thus went into the 1990s weakened, with no improvement in productivity and no track record in disseminating technological innovations or expanding production capabilities.

The international omens in the early 1990s were more favourable, with the Brady Plan (1989) facilitating a return to international financial markets. This more propitious environment played a significant role in the success of the bolder stabilization plans adopted in the 1990s, where the stress was on measures to liberalize the economy, including trade.

The vital macroeconomic advances made as the 1990s went on should not be overlooked, in particular the success of Latin American and Caribbean economies in avoiding new inflationary excesses or any serious loss of fiscal control generally. These were positive aspects of macroeconomic policy administration; however, some of the collateral effects did not receive the attention they merited, and this was particularly true of short-term external capital inflows.

For all the success in combating inflation, there was no strong upturn in growth. Nor was stability wholly achieved, as the period was characterized by a run of external crises that became more recurrent and contagious towards the end of the decade, most particularly the Mexican crisis of December 1994, the Asian crisis of 1998, the Brazilian crisis of early 1999 and the Argentinean crisis of 2000-2001. The result was that growth fell off sharply and volatility increased. This period of stagnation (from the perspective of growth) ended with half a decade of impressive economic expansion (2003-2008) driven by higher commodity prices and a strong impetus from the global economy.

In both the 1980s and the 1990s, the countries of Latin America and the Caribbean tended to follow procyclical policies which amplified the upturns and downturns of the growth cycle (Ffrench-Davis, 2005). These policies passively tracked booms and busts in the supply of capital, so that phases of excessive borrowing coupled with currency appreciation were followed by severe contractions and sharp depreciation (Stiglitz and others, 2006). All this negatively impacted growth, stability and the development of technological and production capabilities, which were inevitably affected as they struggled to adjust to frequent fluctuations in relative prices and in demand and output levels. In particular, the emphasis on balancing budgets and using inflation control instruments (particularly interest rates) without at the same time considering the effects on the exchange rate (and competitiveness) helped to generate a surge in imports and reduce the density of the input-output matrix in Latin American economies. These weaknesses in the production structure meant that exports created few spillovers for the rest of the economy, and this was compounded by increased vulnerability when the phase of favourable external conditions came to an end (Ocampo, 2005).

From 2002 until the outbreak of the present crisis, Latin America and the Caribbean were able to achieve growth rates similar to those of the 1970s. There was a boom period from 2003 to 2007 during which regional GDP expanded by some 5% annually, while per capita

GDP growth exceeded 3% for almost five years running, in a context of positive current-account balances, fiscal surpluses and an unprecedented build-up of international reserves (see figure 1). At the same time, unemployment dropped sharply (from 11% to 7.4%) and the percentage of people below the poverty line fell by 10 percentage points (from 44% to 34%). This highly favourable combination of strong growth and good external balances was without precedent in the region's recent history (ECLAC, 2009a).

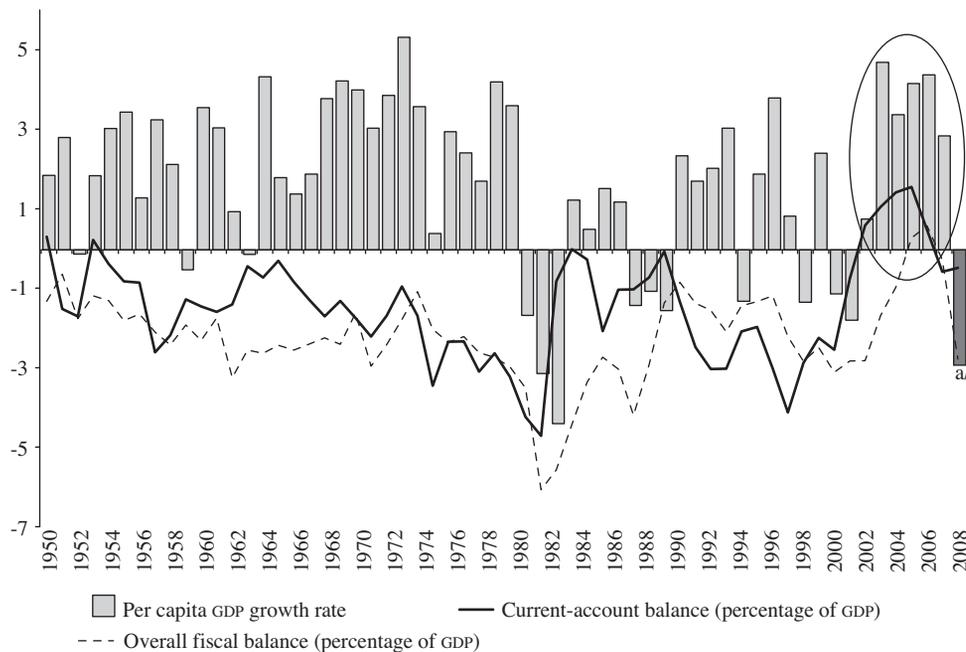
A key factor in obtaining such favourable results was the growth of the world economy, which averaged close to 3.6% a year during the 2003-2008 period (DESA, 2010). This resulted in an expansion of the region's international trade, which rose 138% in value, and a steady improvement in the terms of trade, which improved by 25% over the period. The economic expansion of Asia, and particularly China, where growth averaged 11% a year over the period, was critical to this improved performance in

the global economy, with powerful repercussions for Latin America and the Caribbean (Rosales, 2009). Meanwhile, the new role of the Asian countries in the international economy has a dual character which should not be overlooked. While these countries pose a strong competitive challenge to the region in some branches of manufacturing, they are also driving growth in international demand for the commodities the region exports. This dual effect means that the impact of Asia has varied depending on countries' international specialization. On the one hand, large natural resource-based commodity exporters have benefited substantially from Asian demand and the improving terms of trade. In South America, which is where most commodity exporters are, the terms of trade rose by 33% over the period. Conversely, countries that export labour-intensive goods, such as Mexico, and that are not rich in natural resources (like many of the Central American and Caribbean economies) have suffered greatly from Chinese competition

FIGURE 1

Latin America and the Caribbean: per capita GDP growth, current account and overall fiscal balance

(Annual growth rates and percentages of GDP)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

^a Projection for 2009.
GDP: Gross domestic product.

and are now subject to greater constraints. In turn, countries that export low- and medium-technology goods, like Brazil, have been left in an intermediate situation, although there is evidence that they are being increasingly affected as China diversifies its exports into more technology-intensive goods (ECLAC, 2009b and 2009f).

Unlike other periods, 2002-2008 was distinguished by prudent management of the favourable external shock and by macro policies that yielded positive fiscal results, a build-up of external assets to cope with contingencies, low rates of unemployment and inflation and strengthened domestic financial systems (ECLAC, 2008b).

III

Social trends and changes

Cycles of growth and stability have their counterpart in society. The effects are particularly important in Latin America and the Caribbean, characterized as they historically have been by persistently high levels of inequality. As figure 2 shows, charting poverty over time produces a parabola which roughly tracks the growth phases of the region. Thus, poverty increased from the 1980s to the early 1990s before declining, with the incidence of poverty diminishing from 48% to 33% between 1990 and 2008.

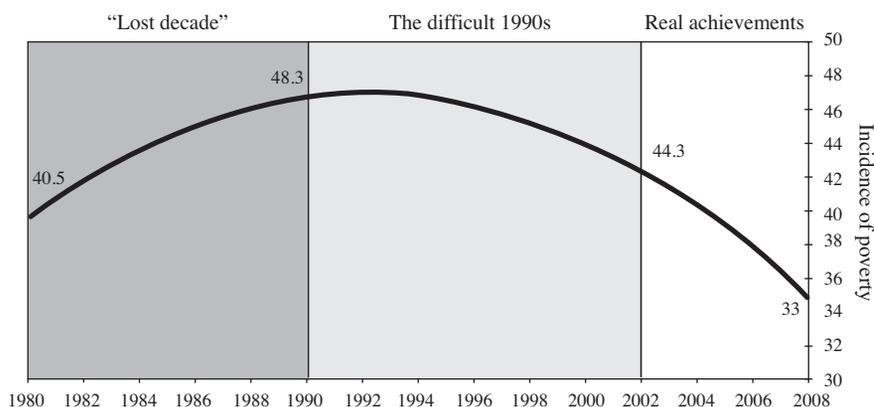
Poverty levels rose towards a peak during the “lost decade” of the 1980s owing to lack of growth and to fiscal restraint, which negatively affected social spending. From the late 1980s to the early 1990s, as growth and employment began to pick up and social policies were strengthened, the trend towards rising

poverty was reversed and it began to retreat. There have been substantial social advances in Latin America and the Caribbean over recent years, improving the overwhelmingly negative picture inherited from the “lost decade”. From 2002 onward, steady growth and the application of social policies on a larger scale drove poverty down to its lowest level of the past 30 years (ECLAC, 2009d).

Six years of steadily declining poverty and inequality ended in 2008. It must be made clear that for all the progress since the late 1980s, there is still a long way to go. In 2008, compared to 1980, there were 44 million additional people living in poverty, and of those 9 million were living in extreme poverty. By the end of 2008 there were still 180 million people in poverty in Latin America, a high enough figure

FIGURE 2

Latin America and the Caribbean: poverty rate, 1980-2008
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

to alert us to the need to improve policies aimed principally at this section of the population.

An assessment of the full six years, including the 2008 results for countries with information available, yields a positive final balance in the struggle against poverty. For the first time, as figure 3 shows, all the region's countries had a lower poverty rate than in 2002 or thereabouts. The percentage annual decline was most substantial in Argentina, the Bolivarian Republic of Venezuela, Peru, Nicaragua, the Plurinational State of Bolivia, Honduras and Brazil, while at the other extreme there were smaller reductions in the Dominican Republic, El Salvador, Paraguay and Uruguay.

The extreme poverty rate also fell everywhere except the Dominican Republic and Uruguay. Although extreme poverty rates generally fell by fewer percentage points than poverty rates, the picture is the

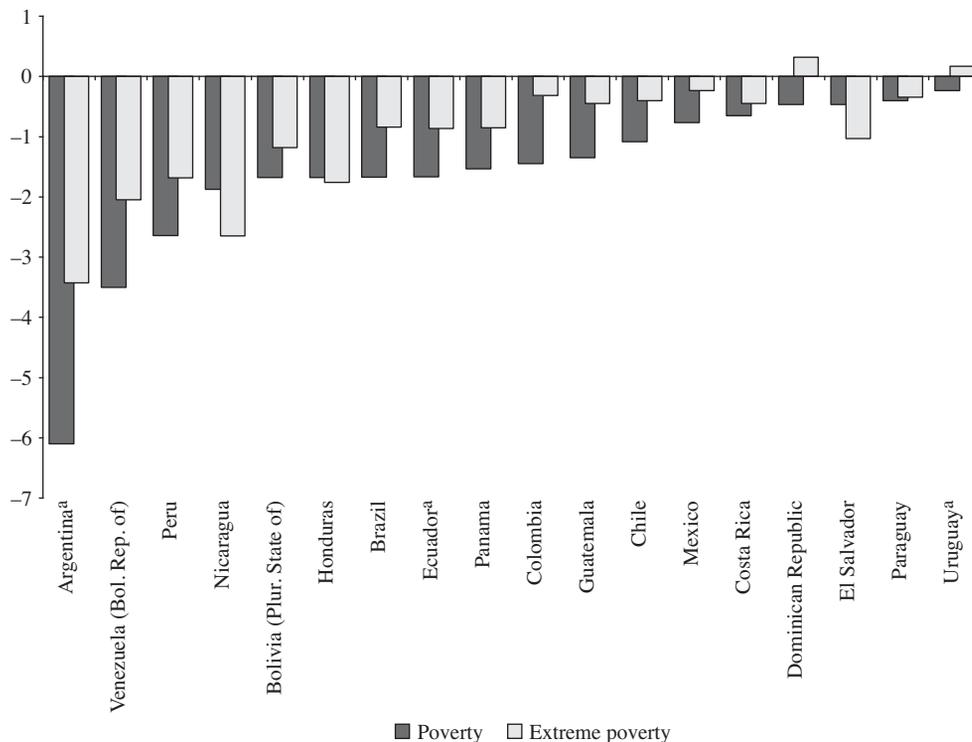
reverse when absolute changes are compared, with living conditions improving especially for those at the bottom of the income distribution despite rising food prices over the last year.

Where inequality is concerned, between 2002 and 2008 the Gini index dropped substantially in several countries, particularly the Bolivarian Republic of Venezuela (-18%), Argentina (-10%), Peru (-9%), the Plurinational State of Bolivia, Nicaragua, Panama and Paraguay (-8% in all of these). The only countries where income concentration increased in the period were Colombia, the Dominican Republic and Guatemala. It should be mentioned that the Colombia data are from 2005 and those of Guatemala from 2006, which means they may not be representative of the 2002-2008 period (see figure 4).

The combination of better distribution and rising average household incomes made a considerable

FIGURE 3

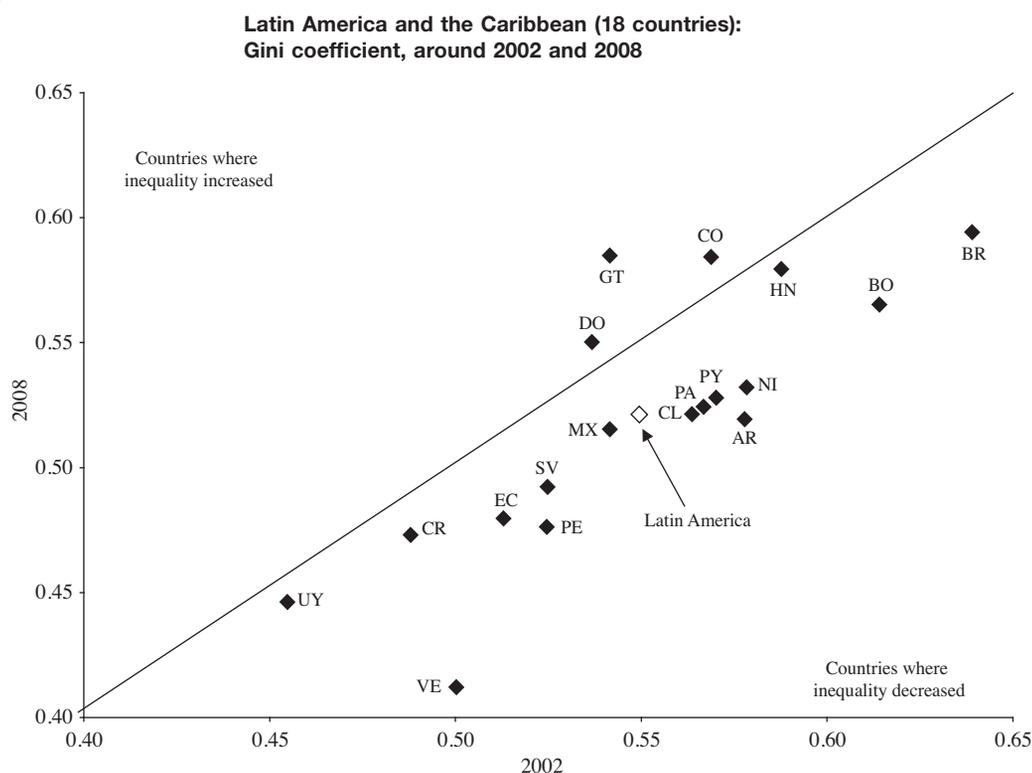
Latin America and the Caribbean: annual variation in poverty and extreme poverty rates, 2002-2008
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of special tabulations of household surveys from the countries concerned.

^a Urban areas.

FIGURE 4



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of special tabulations of household surveys from the countries concerned.

BR: Brazil. BO: Plurinational State of Bolivia. HN: Honduras. NI: Nicaragua. CO: Colombia. PY: Paraguay. AR: Argentina. PA: Panama. GT: Guatemala. CL: Chile. MX: Mexico. DO: Dominican Republic. SV: El Salvador. PE: Peru. EC: Ecuador. CR: Costa Rica. UY: Uruguay. VE: Bolivarian Republic of Venezuela.

contribution to reducing inequality, something reflected by a drop in the Gini coefficient from 0.55 to 0.52. This reduction in inequality is not small (although inequality is still a long way from acceptable levels) and in some countries it has been very substantial, examples being Brazil, Argentina, the Plurinational State of Bolivia, Peru and the Bolivarian Republic of Venezuela. It should be recalled that a reasonable range of variation for the Gini index over a 10-year period is between 5% and 10%. In Latin America and the Caribbean, it dropped by an average of 3% for all the countries over six years, and by more than 5% in some. These are very substantial changes, especially in a region where inequality has traditionally proved very intractable (ECLAC, 2009d).

To sum up, in the third quarter of 2008, Latin America and the Caribbean closed a cycle of economic expansion (2002-2008) that saw substantial and consistent improvements in levels of poverty (which fell from 44% to 33%) and extreme poverty (from

19.4% to 12.9%), in the employment rate (which rose from 52% to 55%) and, in many cases, in equality (a decline in the Gini coefficient from 0.55 to 0.52). Although there are differences between countries, the improvements occurred in almost all of them. This progress deserves to be highlighted, especially given the earlier record of the Latin American economies, with inequality proving particularly hard to correct.

Although the trends have clearly been favourable, the results of the last six years do not change the fact that the Latin America and Caribbean region is one of the world's most unequal. Its record has improved, but not by as much as other developing regions', and the absolute number of poor and extremely poor people remains very high. All this means that governments cannot afford to lower their guard over the coming years in the struggle against social problems that still pose a serious obstacle to Latin American development.

IV

The current crisis, transmission and response mechanisms

Although the region was better placed macroeconomically to deal with this economic crisis than with previous ones, going into it with strong growth, a cushion of international reserves, a better fiscal situation, low unemployment and inflation and relatively sound financial systems, the scale of the present crisis has had substantial negative effects on the countries of the region.

GDP fell by more in 2009 (-1.8%) than at any time since the external debt crisis of 1982-1983. Indeed, apart from a small drop in 2002, it was the first time GDP growth had been negative since 1983. As figure 5 shows, growth has fallen off by more in this crisis than in previous ones, dropping on average from

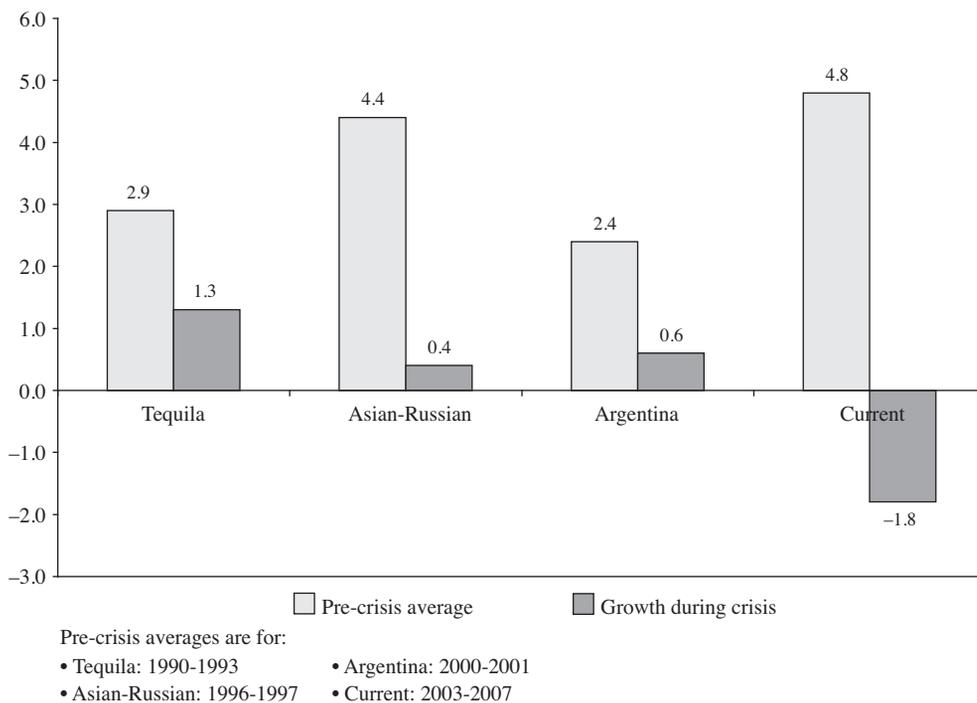
4.8% to -1.8%, which represents a decline of almost 7 percentage points in the GDP growth rate. In the Asian crisis the decline was 4 percentage points, while in the “tequila” crisis it was 1.6 percentage points (Pineda, Pérez-Caldentey and Titelman, 2009).

The effects of financial crises have traditionally been associated with a considerable deterioration in external conditions. Trade has been a particularly important channel of transmission in the present crisis, although there has also been a substantial decline in external financing.

Excluding foreign direct investment (FDI), net financial flows in six of the main countries of the region fell from 1% of GDP in the third quarter of

FIGURE 5

Latin America and the Caribbean: GDP growth before and during crises
(Average growth rates before and during the crisis)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

2008 to -1.5% in the second quarter of 2009.¹ The regional balance-of-payments financial account result, including errors and emissions, fell from US\$ 64.413 billion in 2008 to about US\$ 53 billion in 2009. External financing constraints have led to a contraction in domestic lending, with growth in this indicator falling from 18% in January 2008 to 2% in September 2009.

Restricted though financial flows have become, the trade channel has been more important. The crisis resulted in a sharp dip in trade flows. In 2009, exports are estimated to have fallen by 24% and imports by 25% (ECLAC, 2009b; 2009g). These figures were also associated with a drop in FDI, remittances and commodity prices (see figure 6) (ECLAC, 2009h; Orozco, 2009).

While the emphasis in this crisis has been on the consequences for economic growth, it should not be forgotten that some of its most significant effects have been on employment/unemployment and poverty. The effects on employment have been considerable (see figures 7 and 8): the urban unemployment rate, which dropped from 8.9% to 7.2% between the first and fourth quarters of 2007, rose back to about 8.3% in 2009 as a result of the crisis. The rise in unemployment has

been compounded by a deterioration in job quality in some countries of Latin America and the Caribbean. The increase in the number of people living in poverty, meanwhile, is put at 9 million. As figure 8 shows, the social cost of the crisis is greater than the projected 9 million extra poor, since if the earlier trend had been maintained there could well have been a further 5 million drop in the number living in poverty (ECLAC, 2009a; ECLAC, 2009f).

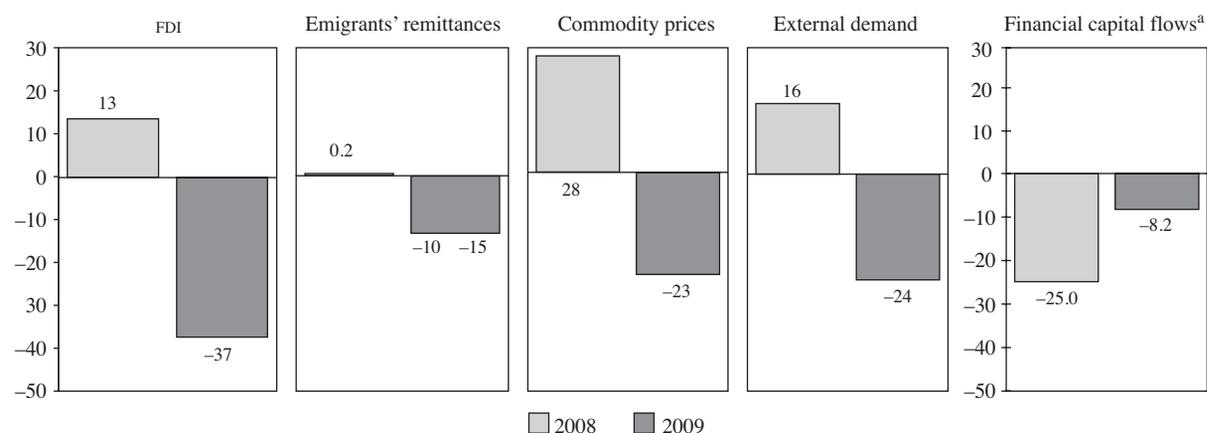
It should be emphasized that the region was able to confront the crisis from a position of macroeconomic strength, as was seen earlier, since it was running a current-account surplus and a fiscal surplus (see figure 1), while the social position was easily the best it had been in 40 years. A crisis whose origins lay outside the Latin American economies was met with countercyclical fiscal and monetary policies which mitigated its impact on growth, economic activity, employment and poverty (Kacef and Jiménez, 2009).

Given the constraints on monetary policy resulting from the low degree of monetization in the region's economies, and considering too the fiscal and institutional difficulties in many of the countries (the lack of projects, the constitution of sectoral spending units and the institutional complexity of allocating, disbursing and evaluating public spending), fiscal policy proved an important

¹ The six countries are Argentina, Brazil, Chile, Colombia, Mexico and Peru.

FIGURE 6

**Latin America and the Caribbean:
crisis transmission channels**
(Annual percentage rates of change)

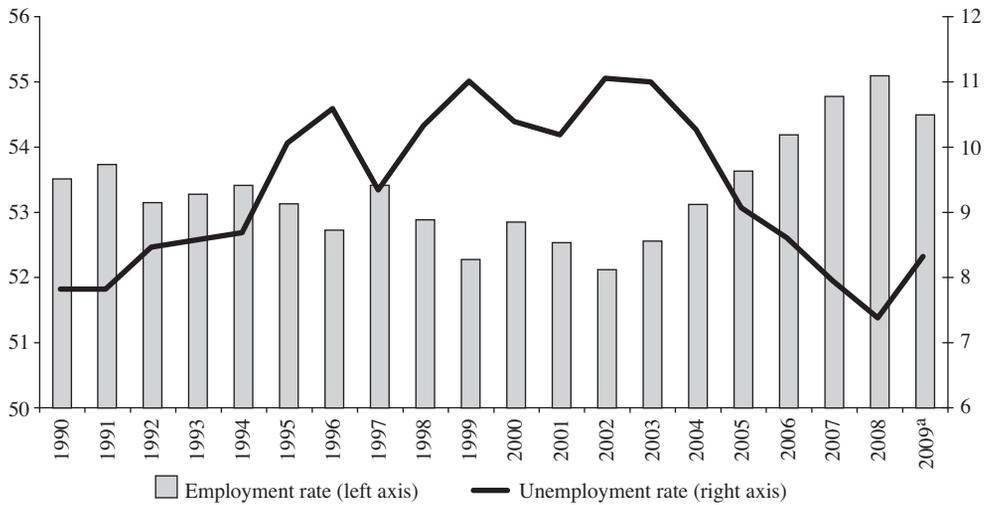


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures. N.B.: The 2009 figures are projections.

^a Financial account plus errors and omissions minus foreign direct investment (FDI).

FIGURE 7

Latin America and the Caribbean: urban employment and unemployment rates, 1990-2009
(Percentages)

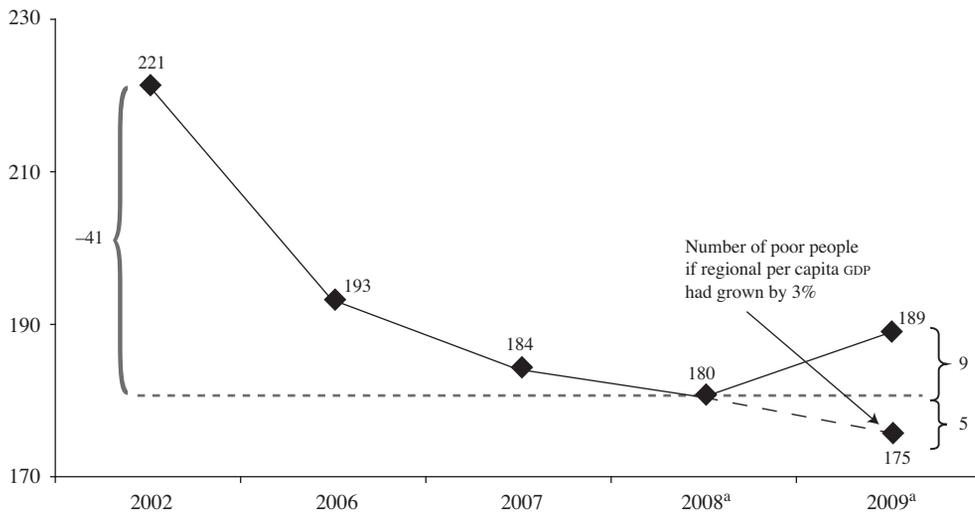


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

^a Estimate.

FIGURE 8

Latin America and the Caribbean: poverty trend and estimated effect of the crisis
(Millions of people)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

^a Estimate.

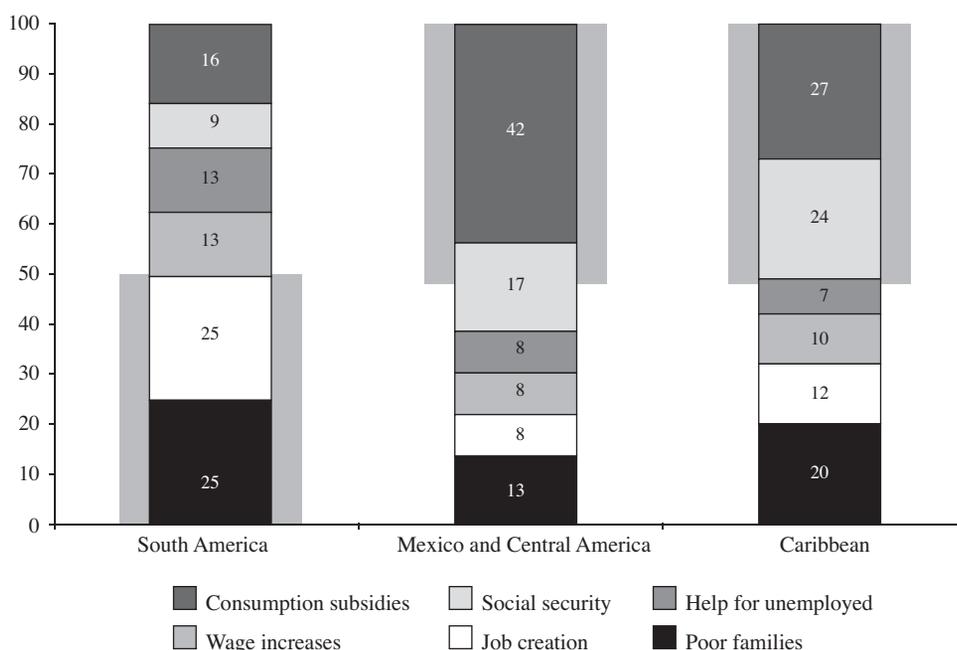
tool for boosting activity in the short and medium term. Despite the obstacles mentioned, the growth rate of public spending increased in some countries and sectoral policies were implemented in the areas of house-building (because of the spillover effects on employment and domestic demand), assistance for small and medium-sized enterprises (SMEs) (because of their importance in job creation) and support for economic sectors, especially agriculture, with a greater emphasis on social programmes, some of them focused on employment policy (see figure 9) (ECLAC 2009e; Sojo, 2009).

Positive signs began to appear across the region's economies in the second half of 2009. Industrial production and exports began to recover, even as rising activity levels overall and higher international trade volumes stoked demand for commodities, pushing up prices and improving the terms of trade. Share markets returned to pre-crisis values, and the region was once again able to tap the international supply of credit.

Projected growth for 2010 is 4.1%, and the figure is expected to be somewhat higher in South America than the rest of the region, given the larger size of some countries' domestic markets and the broader diversification of export markets (ECLAC, 2009a). Also contributing to this expectation is the larger role of China in several countries' trade and the recovery in commodity prices. Conversely, slower growth is expected in more open economies with a portfolio of trading partners that is less diversified and more tilted towards manufacturing (such as Mexico and Central America). Much the same may be said of the Caribbean economies, some of which are experiencing financial and currency difficulties. Generally speaking, the essential factors underpinning this growth are the recovery in private consumption and the rise in gross fixed capital formation, driven in part by fiscal stimulus packages whose effects will be fully felt in 2010. It also needs to be emphasized that commodity prices (particularly energy and minerals) have recovered to their 2006 levels.

FIGURE 9

Latin America and the Caribbean: composition of social programme portfolios announced since the crisis
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official information.

V

The post-crisis scenario and structural constraints

Nonetheless, there is a growing perception that the after-effects of this economic crisis will shift the dynamic of growth and the structure of economic, financial and trading relationships towards what has recently come to be called a “new normal” in the global economy, consisting of the following elements: lower rates of global economic growth, a greater role for emerging economies, a slowdown in trade growth, a tendency towards greater trade protection, a reduction in external credit (at least pending the design of a new global financial architecture that provides more stable conditions of access to external capital) and a transition towards economies with lower CO₂ emissions, with marked repercussions on conditions of access to external markets and the creation of production and technological capabilities.

The recent economic crisis redefined the terms on which Latin America and the Caribbean confronted the challenges of growth and equality. Although the shape of the post-crisis world is still unclear, it will probably be one in which growth is lower overall because of a contraction in aggregate demand in developed countries. Indeed, the potential GDP growth rate of the Organisation for Economic Co-operation and Development (OECD) countries is expected to be about 1 percentage point lower in the medium term because of the crisis (OECD, 2009). The emerging economies could play a more prominent leadership role in this context. The fall in import demand in the developed economies will reduce the scope for emerging economies to sell their products into these markets, heightening competition and at the same time creating incentives for the adoption of growth strategies oriented primarily towards domestic markets, at least in larger economies.

Boosting growth requires changes in the composition of aggregate global demand that will not be easy to bring about. In the medium term, recovering the pre-crisis global growth rate will mean rebalancing aggregate demand between developed and emerging countries. However, there is little consensus or clarity about how this is to be achieved. To give an example, the developed countries account for a very large share of global consumption, with the United States alone

accounting for 34% and the OECD for 84% of the total in 2004-2007. While the emerging economies (Asia, China) have scope to increase domestic demand, they face constraints on their ability to do so.

There is also a need to rebalance aggregate public- and private-sector demand in domestic economies. Fiscal stimuli cannot well be maintained indefinitely, as this would entail substantial growth in public debt. Accordingly, some public demand will need to be replaced by private demand.

In addition, the “new normal” will involve not just lower economic growth but also considerable constraints on financial sector expansion. This will mean smaller financial flows both globally and to developing regions. Consistently with the credit crunch, cross-border financial flows, after rising from US\$ 1 trillion to US\$ 10 trillion between 1990 and 2007 (from 5% to 21% of world GDP, respectively), dropped significantly in 2008 to US\$ 3.1 trillion (2% of global GDP) (McKinsey, 2009). Private-sector financial flows to developing economies practically halved between 2007 and 2008 from US\$ 1,250 billion to US\$ 650 billion. The projected figures are US\$ 350 billion for 2009 and an estimated US\$ 670 billion for 2010 (IIF, 2009).

This trend will be contributed to by an increasing domestic bias, greater financial protectionism and changes to current financial regulations. Accordingly, there is expected to be less global financial integration, with a lower level of cross-border flows (financial protectionism). Changes in financial regulation will result in far more exhaustive oversight and regulation to seal the gaps that existed before the crisis. Supervision will be further-reaching, encompassing the different market instruments and participants. This dynamic will result in the model changing to create a banking system that is more transparent and has lower levels of risk and leverage.

Lastly, the new normal will also bring changes to trade patterns. In particular, global trade growth is expected to slow. Predictions are for world trade volumes to contract by some 10% in 2009 before growing by about 1% in 2010 (WTO, 2009; IMF, 2009). The decline is expected to take place mainly in the

developed nations, followed by a trade contraction in China.

These projections are based on expectations of a prolonged slowdown in import demand in the developed economies, greater use of “protectionist” practices, a slow recovery in credit and payment systems and the disruption of global production chains.

1. Investment and the productivity gap

While recognizing that macroeconomic policies operate in the short term, it is important to realize that the production structure, or some fundamental features of it like investment and productivity dynamics, influence and affect the dynamic of macroeconomic variables (Ocampo, 2005). Willingness to invest in the region, and thus the dynamic of productivity growth, has been affected by speculative financial flows and the risk of local crises of the kind that have tended to arise when capital flows have been cut off. In the long term, indeed, volatile output growth and unstable net capital inflows have translated into periods of underutilization of production capacity and deterioration of accumulated capital. The volatility of these flows (which has contributed to the volatility of economic growth) and the stagnation of domestic savings represent a serious constraint on efforts to renew investment and expand production capacity.

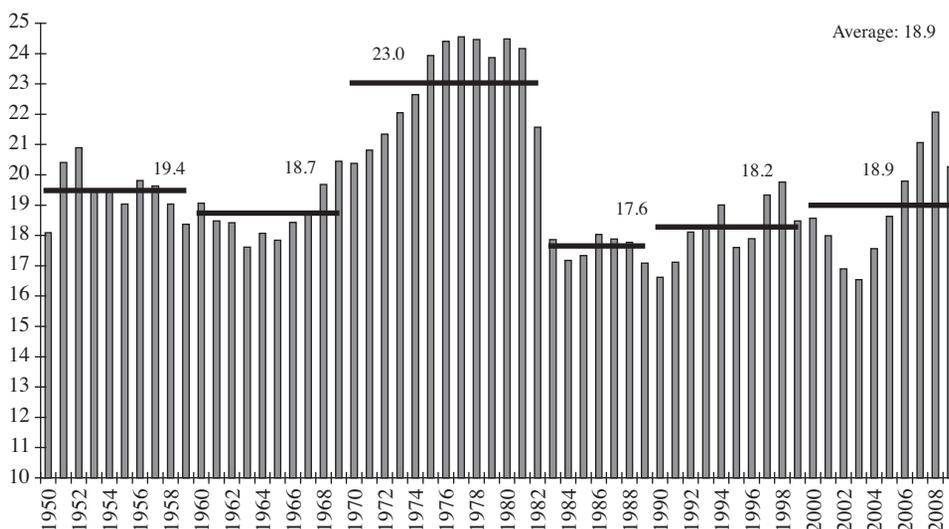
As the economies of Latin America and the Caribbean come out of recession, actual GDP is once again lower than potential GDP, creating scope for a rapid recovery. Unless investment and thus production capacity begin to grow again, however, expansion of the production frontier and the consequent rise in potential GDP will be curtailed. In this context, the investment gap relative to GDP is still a determinant of the region’s development pattern (see figure 10).

There is an important debate in progress about the factors accounting for economic growth and the production frontier in the long run. While this debate is not yet over, opinions are converging on the idea that the ability to innovate and rapidly disseminate international technological best practices within the production structure is one of the keys to this growth. This position has been advocated by ECLAC since its earliest days (Prebisch, 1949) and is a very important aspect of its more recent contributions (ECLAC, 2007). From the ECLAC perspective, technological learning is closely tied to the production structure and to the institutional framework for education, science and technology activities.

The view taken is that the greater the weight of technology-intensive sectors in the production structure, the faster learning processes arise, innovation rates increase and domestic and international demand for a country’s goods expands. This last effect exists not

FIGURE 10

Latin America and the Caribbean: investment rate, 1950-2008
(Percentages of GDP on the basis of dollar figures at constant 2000 prices)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

only because demand for more technology-intensive goods is particularly dynamic, but also because technological capabilities are essential for an economy to adapt and respond to the frequent transformations that occur in the international market. Without these capabilities, exports will lose dynamism and growth will slow, leading to stop-go cycles whose rhythm is determined by external crises and booms in commodity prices or the availability of external financing — as has so often happened in the region.

The empirical literature recognizes the vital role played in economic growth by the production structure and the incorporation and dissemination of technical change (ECLAC, 2007). Recovery is more or less assured in the post-crisis period, as it is starting from very low output levels, but strong and enduring growth (which means a rise in investment and potential GDP) is a more doubtful proposition. Despite the recent boom, the evolution of the economy and the industrial sector in recent years does not seem to have led to major structural changes, a situation that is

largely reflected in the industrial trade balance issues referred to. A similar conclusion emerges when the productivity levels achieved by the region's countries are compared directly with those of the United States. The huge gap that currently exists is a measure of the challenges the region will have to confront in the coming years.

The relative labour productivity index for the industrial sector in Latin America and the Caribbean shows that the productivity gap did not narrow over the whole of the period considered (see figure 11). The gap tended to widen over the 1980s before stabilizing in the 1990s. From the mid-1990s, however, the relative productivity index began to decline again (meaning that the productivity gap widened). It is important to note that the contraction was particularly acute in the last six years of the series. There are two reasons for this. First, labour productivity in the industrial sector of the countries of the region rose by 2% a year between 2003 and 2007, the indicator's worst performance in the last 36 years except for the “lost

FIGURE 11

Productivity in Latin America and the Caribbean relative to the United States and productivity in the United States economy, 1970-2006
(Percentages and index value)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
N.B.: Productivity measured in industrial sectors.

LAC: Latin America and the Caribbean.

decade” of the 1980s. Second, after rising by about 3% a year for 20 years, productivity in the United States began to grow by 5% annually in the mid-1990s.

It is important to stress the role played in productivity trends by the interaction between the short and long term and by different economic policies. Every time there is a shock (in prices or the real exchange rate), productivity is lower throughout the adjustment period (Cimoli and Porcile, 2008).

In other words, each shock has a structural impact, the ensuing changes and adaptations in production processes are costly, and it takes time to restore earlier competitiveness. The speed with which firms respond to shocks and the direction of change are critical in determining whether they remain competitive in the international marketplace. Consequently, there will be a spell in which productivity in the economy inevitably grows less strongly, and in Latin America and the Caribbean at least, this does not imply a longer-run rebound.

The time taken to adapt clearly depends on many factors, such as the particular characteristics of firms’ assets, productivity differentials between sectors and businesses, firms’ management strategies and the general characteristics of human capital. In other words, there is a degree of rigidity in the technological and production capabilities of firms that determines the duration and direction of the adaptation process. This can result in a new, more competitive firm with an increasingly diversified product mix, or it may lead to the firm’s disappearance.

The end result where labour productivity is concerned is that Latin America and the Caribbean are not catching up with the frontier (represented by the United States). The effects of the different crises are clearly visible in figure 11, which reveals an extraordinary plunge in relative productivity during the 1980s debt crisis, a modest recovery from the early 1990s and a new contraction beginning in the second half of the decade (the “tequila” crisis). Underlying these fluctuations are alternate periods of currency appreciation, trade liberalization and rising external debt, followed by fresh devaluations, as mentioned earlier.

Tackling the productivity gap is unquestionably crucial when it comes to sustaining international competitiveness with equality, as Fajnzylber has pointed out (Fajnzylber, 1990). However, there is a new key economic transformation variable whose importance has grown steadily over time, namely environmental sustainability, which will now be discussed.

2. Sustainable structural change and the environment

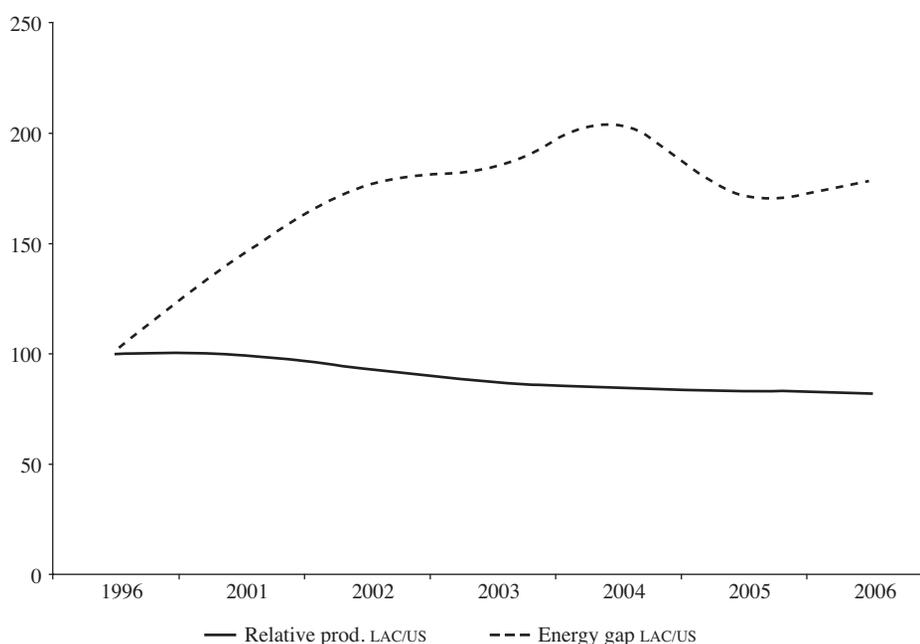
To achieve a development pattern that is virtuous and sustainable over time, macroeconomic equilibria are obviously not enough. There will also have to be a process of structural change that narrows the productivity lead of the most developed countries (convergence), as ECLAC has been arguing since the era of productive transformation with equity. There are now very clear signs that the growth pattern predominating in the world is not compatible with conservation of the environment. The estimated costs of environmental damage, including climatic problems with all their destructive consequences for human, physical and natural capital, are becoming increasingly evident. From an environmental sustainability standpoint, however, it is now imperative to find the path to growth that entails the least energy consumption per unit of output and the smallest impact on the environment.

The scenario in which the productivity divide is closed without exacerbating environmental problems can be defined as one of sustainable convergence. In point of fact, engineering-intensive sectors use less energy per unit of output than natural resource- or labour-intensive sectors. However, structural change in the region has not gone in the right direction as regards either technology or energy, since the picture is generally one of divergence in productivity combined with an energy consumption pattern that is unsustainable over time (unsustainable divergence). This type of growth pattern is often associated with intensive use of natural resources, as it prevails in mature sectors where technical change is incorporated more slowly. Furthermore, greater use of natural resources entails higher energy consumption. On the basis of the data presented earlier, it can be concluded that energy consumption per unit of output is expanding relative to the energy frontier and, simultaneously, that the region is not catching up in terms of productivity. Figure 12 gives a graphical description of the situation, with a “scissor” shape that opens up over time depicting the widening of the productivity and energy gaps between Latin America and the Caribbean and the United States.

Some of the highest growth in fossil fuel emissions is to be found in the Caribbean, particular examples being Trinidad and Tobago, Jamaica and the Dominican Republic, although some Caribbean countries such as Cuba and the Dominican Republic have made considerable progress with reforestation.

FIGURE 12

Latin America and the Caribbean (4 countries): energy gap and relative productivity,^{a,b} 1996-2006
(Index values)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of figures from the Industrial Performance Analysis Program (PADI) and industry surveys from the countries: National Institute of Statistics (INE) in Chile, National Administrative Department of Statistics (DANE) in Colombia, National Institute of Statistics, Geography and Informatics (INEGI) in Mexico, Brazilian Geographical and Statistical Institute (IBGE) and Bureau of Economic Analysis (BEA) in the United States.

^a The countries taken are Brazil, Chile, Colombia and Mexico.

^b The energy gap is measured by the ratio between the energy intensity indicator for the region's countries and that for the United States.

In the Latin American context, this is expected to be one of the regions hardest hit by a combination of climate change effects manifested in bleaching of 75% of coral reefs in the coming 30 to 50 years (Samaniego, 2009), owing to rising ocean temperatures, the loss or erosion of land caused by the thermal expansion of the sea and the growing intensity of extreme weather events such as floods and hurricanes. Given its limited economic diversification, with heavy dependence on the primary sector and tourism, the region could face very substantial economic repercussions.

Energy efficiency and environmental protection are among the demands imposed by climate change, and count among the challenges for Latin America and the Caribbean in the new international context. ECLAC has projected that, without international mitigation efforts, by the end of the century the region could be experiencing large losses in agriculture and biodiversity, severe pressure on infrastructure and a

rise in the intensity of extreme events, the cumulative impact of which could add up to a substantial portion of current GDP (ECLAC, 2009c). Unless urgent action is taken to alter this path, environmental strains will reach historically unprecedented proportions over the coming decades. The scientific evidence is very conclusive and urgent changes are needed in modes of production and consumption, especially where energy is concerned.

Following the sparse (and legally non-binding) results of the World Climate Change Summit in Copenhagen in December 2009, where participants agreed to limit the global temperature rise to two degrees centigrade, but without setting emissions figures for 2020 and 2050, and to commit resources to poor countries to allow them to stop deforestation, the challenge of moving towards lower-carbon economies has taken on a renewed urgency. Two international approaches remain open. The first is

to follow a negotiated path based on shared values, agreed timetables and matching efforts and criteria based on common but differentiated responsibilities within a framework of multilateral negotiations. The second is to go down the road of unilateral initiatives applied indiscriminately and without distinction as to relative development levels, and governed only by the laws of competition.

Among the measures that will form part of the climatic and economic “new normal” is the application of unilateral trade regulations based on the carbon content of goods exported to the developed economies, implying a serious risk that mitigation could largely be shifted on to developing economies, if not in this way then through other economic channels such as conditional access to credit. Consideration is also being given to applying countervailing tariffs to imported carbon-intensive goods from 2020. Developing countries will need to prepare themselves if they are to avert a possible loss of export markets as competitors better equipped to meet these demands appear.

In summary, the problems of sustainability and the new regulations beginning to appear around the world could become another constraint on economic growth in Latin America and the Caribbean. However, if this new context is taken as an opportunity to renew infrastructure, improve production and technological processes with a view to creating more efficient means of transportation and put in place new lower-emissions production methods, fresh prospects for long-term growth could open up. This will mean coordinating investment incentives (still very limited) and national innovation systems (still weak) to boost investment and innovation rates on the basis of less polluting technologies. There is thus a need to ensure that Latin America and the Caribbean have access to the sustainable technology frontier and can approach it more quickly.

3. Distribution and the equality gap

Latin America and the Caribbean continue to display high levels of inequality and, as already mentioned, there is no prospect of reducing these inequality and poverty rates in a context of low growth where employment and productivity also remain low. Growth does not in itself guarantee improvements in income distribution, but in combination with more determined and consistent rights-based social policies (Hopenhayn, 2001) it has a crucial role to play in improving it. On the other hand, rising productivity

itself makes it viable (under certain conditions) for output, wages and employment to expand in parallel, helping to reduce heterogeneity in the production system and close the productivity gap (Infante and Sunkel, 2009).

Social indicators reflect a positive trend that is a product of economic growth, but also of institutional advances and public policies for fighting poverty, exclusion and inequality. The first evidence for this is the steady growth of social spending over more than two decades, both in per capita terms and as a percentage of GDP. Changes in income distribution over the period contributed to the reduction in poverty, although not by as much as they could have. The change in poverty and extreme poverty rates can be broken down into two components: average income growth, or the “growth effect”, and changes in the way income is distributed, or the “distribution effect”. This type of analysis allows us to see that the “growth effect” was the main factor explaining the retreat of poverty between 1990 and 2008, accounting for about 85% of this, while the “inequality effect” accounted for the remaining 15%. The contribution of distributional improvements to poverty reduction occurred chiefly in the 2002-2008 period (ECLAC, 2009d).

Labour income was the source that contributed most to reducing poverty between 1990 and 2008. The positive change in per capita labour income was due chiefly to the decline in the demographic dependency ratio (commonly termed the “demographic dividend”) in all countries other than Uruguay, and to a large increase in the economic activity rate. Equally, income per worker differed substantially between countries. The countries where poverty fell most (as a percentage variation in the rate)—namely Brazil, Chile, Costa Rica, Ecuador (urban areas) and Panama (urban areas)—are the very ones where income per worker in poor households increased the most. Colombia is an exception here, since although this variable did rise substantially, poverty declined at a considerably lower rate, partly owing to a rise in unemployment. In the other countries, income per worker tended to decline.

One worrying feature of the poverty trend in Latin America and the Caribbean is the persistence of divides in people’s vulnerability to poverty depending on demographic characteristics, particularly age, sex and ethnic origin. Children are among the most exposed to poverty. The incidence of poverty is 1.7 times as high on average among under-15s as among people over that age. Between 1990 and 2008, the ratio

between child and adult poverty rates rose in most of the region's countries, the largest increases being in Brazil, Panama and Uruguay.

Despite the active policies implemented, the crisis reversed two trends that had become well-established over the previous five years: the decline in unemployment and in poverty. Public social spending, along with spending on industrial policies, is essential to consolidate what has been achieved and to enhance equality.

The crisis in Latin America and the Caribbean in the early 1980s severely constrained public spending. The policy options for closing the widening fiscal gap (the subject will be returned to in the next section) were to increase the tax take or cut public spending, and it was the latter option that was chosen as the adjustment variable to restore the fiscal accounts, with all the negative effects that ensued for social spending at a time of diminishing well-being in society.

The upward trend in public social spending since the early 1990s is indicative of the progressive commitment of the Latin American countries to allocating public resources to social policies, thereby giving these stronger financing guarantees and greater institutional stability and legitimacy, although such efforts have been limited considerably by the degree of development attained by the countries (ECLAC, 2006). In the face of old and new social and economic risks in each country, the availability of public resources to finance social protection systems is directly related to governments' tax-raising capacity. Tax burdens continue to be low in the region, however, and this is a factor that weighs heavily on budgets. Nonetheless, governments have made considerable efforts to increase the sums budgeted (in a context of greater fiscal discipline than before), particularly those earmarked for social functions. Despite such government initiatives to increase it, social spending in the region is still inadequate and is not having the impact needed to improve well-being and equality. Its behaviour is still procyclical and it tends to tighten at times of crisis. This illustrates the budgetary constraints and limitations facing the least-developed countries, as it is these that have the least capacity for taking countercyclical measures at times of economic contraction.

4. The fiscal gap and public policy financing

The subject of the fiscal gap should be very prominent in future policy design, as it affects variables that are extremely important both in the short term (such as

inflation and the activity level) and on a longer view (the capacity for financing social and production policies). Public policies require financing mechanisms that do not go counter to the goals of macroeconomic stability, learning and innovation, and equality.

In the period from 2002 to 2008, sound fiscal policy management (Martner, 2007) and the favourable international situation and macroeconomic environment led to improvements in macroeconomic policy design and management and to a reduction in the vulnerability of the public and external accounts, allowing debt stocks to be reduced and reserves to be built up. In 2006 and 2007, Latin America and the Caribbean as a whole recorded a fiscal surplus for the first time in the region's history (see figure 1).

As the crisis progressed in late 2008, the existing need to mitigate volatility, strengthen growth and enhance equality in the societies of Latin America and the Caribbean was combined with new demands for countercyclical policies and instruments to protect the most vulnerable population from negative distributional impacts. In this context of higher spending demands at a time when fiscal revenues were falling because of lower commodity prices and activity levels, the greater policy leeway obtained in earlier years was reduced significantly (fiscal deficits in 2008 and 2009 were -0.3% and -2.8% of GDP, respectively).

The fiscal gap is not just something that appears in difficult periods, however, but is actually a structural problem in the region's countries and is also connected to the inequality characterizing them.

The manifold problems associated with a fragmented society where a small percentage of the population owns much of the wealth and large groups of households are below the subsistence line indicate a need to redefine the role of the State in the redistribution of income. The three main characteristics limiting the redistributive role of the State in the region are low tax burdens, the regressiveness of taxation systems and the misallocation of public spending.

The countries of Latin America and the Caribbean have low levels of tax collection (although there are large variations between countries). The tax burden averages about 18% of GDP in the region, a low level given its degree of development, particularly when compared to the financing needs implicit in public policy demands. This means that public sectors have a very limited pool of resources on which to draw to meet the demand for goods and services from large sections of the population. The situation is even more extreme in certain Central American countries that

have tax burdens of some 10% of GDP and great social needs as a result of extremely high poverty levels.

Furthermore, tax systems in the region are regressive, i.e., they heighten income disparities. Less than a third of the tax collected comes from direct taxes, with most of the burden falling on consumption taxes and other indirect forms of taxation with clear regressive effects. The end result is that after-tax income distribution is if anything more inequitable than primary distribution. The need, then, is to strengthen direct taxation and strike a better balance between this and indirect taxation. Any attempt to reform the tax system so that it redistributes resources to the poorest will require a redesign of income tax and asset taxes. The latter ought to account for a larger proportion of all tax collected, and to be more progressive. However, these efforts will need to be accompanied by greater control of tax evasion and avoidance, as these are major sources of inequality and of injustices that imperil the legitimacy of tax

systems, ultimately affecting their revenue-raising capacity. Higher tax collection is needed, therefore, but so are efforts to correct the regressive bias of the tax structure as far as possible.

Meanwhile, the volume and quality of spending need to be assessed for appropriateness. At times of crisis like the present, increasing or maintaining social spending becomes a priority, and it is important to assess its redistributive potential and the scope for targeting it on the most vulnerable population groups.

To sum up, there are problems with the quantity and quality of public spending that need addressing, and the relationship between taxpayers and beneficiaries, which has tended to heighten inequality in Latin American societies, ought to be reshaped. Consequently, there is a need for a new fiscal covenant (ECLAC, 1998) that spells out policy priorities and the sources of financing required to implement them, with growing influence for citizens in the decision-making process through democratic institutions.

VI

Final reflections

The 2008 crisis and the signs of recovery that have recently appeared hold important lessons for Latin America and the Caribbean, concerning not just short-term mitigation of the effects of the crisis, but also the long-term vulnerability of the predominant growth pattern. The equality, productivity, investment and fiscal gaps that have long acted as obstacles to growth with equality are still there, compounded now by increasingly urgent demands relating to the environment and climate change. The persistence of old gaps and the appearance of new ones suggest very clearly that the policy responses traditionally offered by the region have not been enough to spur development.

On top of this, the contours of the post-crisis scenario do not seem to be those of the past. While the region may have recovered its former growth rate in late 2009, with an expansion of 4.1% forecast for 2010, it will be faced with a different context. In the course of 2010, those elements that some see as constituting what has begun to be called the “new normal” in the global economy will start to become increasingly evident. They are: lower rates of growth in the global economy; a new role for emerging economies; slower growth in trade flows; greater financial protectionism;

the construction of a new global financial architecture; and a shift towards economies with lower CO₂ emissions. This new reality makes the old policy responses (both excessive protectionism and ill-considered liberalization) even less appropriate, and strengthens the case for a fresh approach.

The view taken in this study is that the structuralist tradition offers valuable insights for our understanding of the crisis and the post-crisis situation, with emphasis on the role of policies designed to reform the production structure and disseminate technical progress as a central component of growth with equality and sustainability. This thinking is all the more relevant when climate challenges are considered, as they entail changes in the way we produce and consume and in the way energy is generated and used that are making the carbon footprint a leading variable in countries’ competitiveness. Adaptation and emissions reduction policies require long-term planning. Furthermore, the new normal of environmental economics will involve carbon emissions caps and incentives, penalties or taxes likewise designed to reduce emissions, tradable emissions permits and even trade regulations based on the carbon content of exported goods (“carbon footprint”).

Automatic market mechanisms are not enough by themselves to deal with this whole complex challenge of structural transformation. Besides, the market will generate new social and political strains and conflicts that will have to be responded to with more than purely economic thinking. It is therefore natural to expect politics to begin to play a leading role in the construction of the future once again.

This means, first of all, thinking in a “long-term” framework again in order to achieve equality through a rights and citizenship approach, with a welfare society as the ultimate goal. The short-term problems of the crisis need to be resolved from a long-term perspective, which means developing the capacity to devise and implement public policies that can reconcile the different time horizons. The future will be constructed with ideas, clear leadership and long-term strategic visions but also, and essentially, with overarching political and social agreements to make development pathways viable and provide the countries of the region with democratic governance. It is essential to have a long-term strategic vision nurtured by the sovereign will through the institutions of democracy. These are ingredients inherent in the very concept of development.

Secondly, the centrality of politics makes it more urgent to consider what new functions the State needs to discharge to give substance to citizens’ development aspirations. It was long assumed that the market could provide public goods without intervention, but there is an increasing recognition that this is not the case. The State is the locus of political action and its role needs to be redefined so that it can guarantee provision of these goods. A new balance needs to be struck between State, market and citizens, and this will require the creation and reinvention of public, private, solidarity and community institutions. This, in turn, calls for the development of better systems for organizing and assessing public-sector administration in the interests of accountability and transparency. Reclaiming the public space for the collective action of all citizens rather than just the government or the State

is essential for inclusiveness and for the full exercise of citizenship, and thence for the determination of a country’s priorities.

Underlying this whole task, thirdly, is the construction of a solid “fiscal covenant” that turns tax systems into more progressive structures and make policy financing viable. It will not be possible to achieve the different objectives proposed and give policies a wider role without the construction of political agreements, whether explicit or implicit, regarding the level, composition and direction of public expenditure and its financing.

Taken together, all these points add up to a need to design a “new State architecture” allowing the State to play an important role once again in the general welfare and as a leader in Latin American countries’ development strategies, thereby escaping the paradigm of “subsidiarity” relative to the market. What is proposed is that the role of the State be redefined on the basis of a critical assessment of its historical performance, with proposals to endow it with adequate tools so that it can find its proper place in equilibrium with the market and citizen rights—not just the current generation’s, but also those of future generations, who will be inheriting an increasingly precarious environmental balance.

To sum up, while one size does not fit all and no model is right for everyone, and it is true that each society will have to consider and agree upon the right balance to strike in the light of its own development dynamic, it is also universally agreed that the State will have to play a more significant and assertive role in guaranteeing public goods, dynamizing growth, achieving economic stability, working for equitable fiscal reform, promoting the necessary economic convergence with innovation and generating consensus around fiscal covenants with clear redistributive effects. It is within the framework of this welfare State, as opposed to a merely subsidiary State, that it will be possible to relaunch development goals under the new conditions and rules being set in the post-crisis international economy.

(Original: Spanish)

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