CEPAL

Review

Director
RAUL PREBISCH

Technical Secretary
ADOLFO GURRIERI

Deputy Secretary
GREGORIO WEINBERG

UNITED NATIONS
ECONOMIC COMMISSION FOR LATIN AMERICA

SANTIAGO, CHILE / AUGUST 1983

CEPAL

Review

Number 20 Santiago, Chile August 1983

CONTENTS

Note by the Director 7

Letter from the Constitutional President of the Republic of Ecuador, H.E. Dr. Osvaldo Hurtado to Messrs. Enrique V. Iglesias, Executive Secretary, ECLA, and Carlos Alzamora, Permanent Secretary, SELA 9

Letter from Messrs. Enrique V. Iglesias, Executive Secretary, ECLA, and Carlos Alzamora, Permanent Secretary, SELA to H.E. Dr. Osvaldo Hurtado, Constitutional President of Ecuador 11

Bases for a Latin American response to the international economic crisis. *Carlos Alzamora T.* and *Enrique V. Iglesias* 17

The world crisis and Latin America. Conclusions of the meeting of leading personalities convened by ECLA in Bogotá from 19 to 21 May 1983 47

The crisis of capitalism and international trade. *Raúl Prebisch* 51

Latin America: crisis, co-operation and development. *Guillermo Maldonado, Eduardo Gana* and *Armando Di Filippo* 75

Renegotiation of Latin America's debt: An analysis of the monopoly power of private banks. *Robert T. Devlin* 101

Wages and employment in international recessions: recent Latin American experience. *Víctor E. Tokman* 113

Is there a fair and democratic way out of the crisis? *Adolfo Gurrieri* and *Pedro Sáinz* 127

The external debt and the financial problems of Latin America. *Carlos Massad* 149

Some CEPAL publications 165

CEPAL REVIEW No. 20

Wages and employment in international recessions:

Recent Latin American experience

*Víctor E. Tokman**

This article takes as its working hypothesis the postulation that while the international recession makes it necessary to effect internal adjustments involving a lower level of activity, there are various alternative ways of tackling the situation, these options being partly determined by the structural characteristics of the economy, but also depending on the set of policies applied. In order to corroborate the hypothesis, the adjustment policies followed by various Latin American countries in the last two crises are analysed, and it is concluded from this that if we leave out the group of countries which are so small and open that they have little autonomy in facing the crisis, the economic history of the last five years shows the failure both of the global monetary policies followed in the Southern Cone and of the expansive policies of the oil-exporting countries. The more eclectic models applied by other countries, although markedly different from each other, appear to have been most effective in reducing or at least postponing the cost of the adjustment and sharing it out more equitably.

Two specific aspects are also analysed: the repercussions of the increase in interest rates on the Latin American economies, and the adjustment of the labour market, which takes different forms from one country to another. In some countries, this adjustment takes place through an increase in open unemployment; in others, through an increase in underemployment, and in yet others, through a combination of both factors. The reasons why the adjustment takes these different forms are analysed, together with the implications of this fact. It is postulated that in fact the reduction in the income of those working in own-account occupations plays the role of a collective unemployment insurance policy and constitutes in practice a second-best solution from a welfare point of view.

*Director, Regional Employment Programme for Latin America and the Caribbean (PREALC).

I

Introduction

Latin America and the Caribbean, like the rest of the world, have gone through several international crises during the last decade which have made it necessary to introduce adjustment policies in the economy. Adjustment is of course inevitable, since it is necessary that the national economies adapt themselves to a reduced availability of real resources. Nevertheless, there is more than one possible adjustment policy and, given this diversity as well as the varying modes of application, different results may be produced.

In the first place, as regards the period required to produce results, there is a difference between policies that affect the level of expenditure and policies that operate through changes in relative prices as the principal mechanism for shifting resources from the production of goods for domestic utilization to the production of tradeables. Generally speaking, the trend in the reduction of domestic expenditure should be to concentrate on lowering consumption rather than investment, so as to avoid eventual adverse effects upon economic growth. At the same time, however, adjustment to the international recession has coincided with inflation in most Latin American and Caribbean countries, making it necessary to apply both adjustments simultaneously. The final result is that adjustment policies cease to be neutral and basically hit wages and employment levels. Wages suffer because they are usually regarded as the key variable for stabilization of price levels, for fostering an improvement in international competitiveness, and for inducing a contraction in the level of consumption. Employment levels are affected, for their part, because a lower level of domestic expenditure generates a higher level of open unemployment.

The current world crisis, as well as that suffered at the beginning of the 1970s, is different from other international fluctuations to which the economies of the region and the developing world have been historically subject, for the size and depth of these recent crises have affected not only developing countries but also those at the centre. In this connection, a comparison is increasingly being drawn between the present recessive conjuncture and that experienced in the 1930s.

There are at least two important differences between the Great Depression of over half a century ago and the present recessive situation, however. In the first place, given the crucial role currently played by the rise in oil prices, the question of whether a country produces it or not and exports it or not furnishes a first major differentiation between economies, irrespective of whether they are located in the north or in the south. In the region, this differentiation can be clearly perceived in the dissimilar performance in the present crisis of the oil-exporting economies as compared with the rest of the continent.

In the second place, in contrast with the 1930s, the present international recession and the one before it have been accompanied with inflation in the developed world. This has at least two direct implications. On the one hand, the deterioration in the terms of trade of the non-oil-exporting countries of the region is at present greater than that observed in the 1930s. The terms of trade of the Latin American countries decreased at an annual rate of 6.7% between 1930 and 1933, whereas this deterioration attained an annual rate of 8.4% in the 1974-1975 crisis and 9.6% from 1978 to 1981, in the non-oil-exporting group. Even so, in contrast with what happened in the 1930s the decline in the purchasing power of the region's exports has been less severe, and even in the current crisis the expansion of the export quantum has more than compensated for the fall in the terms of trade.

On the other hand, the policies pursued in the central countries and especially in the United States during the present recession have involved a considerable rise in nominal interest rates, this occurring at a time when the foreign indebtedness of the countries of the Region has increased significantly. This rise exceeds the rate of growth of the export prices of the non-oil-exporting Latin American countries, and amounted between 1978 and 1981 to an increase of 47.5% in the prime rate and of 32.6% in the rate applicable to Eurodollars, both in real terms.

The aim of this paper is to review the relationships between the aforesaid variables, which summarize the effects of the international recession on the economy of the countries in the region, and the behaviour of wages and employment. To this end, special attention will be paid to the periods 1973-1975 and from 1979 to the present. On the basis of this review, the different reactions of various countries of the region to the international situation can be identified as well as the extent to which the latter has affected wages and employment. With this in view, and given the difficulties that would be involved in analysing all countries of the region, a broad typology of situations will be made and illustrated by an analysis of some particular cases. The discussion, moreover, will necessarily be restricted, since a comprehensive analysis of the adjustment process, given its macroeconomic character, would take us beyond the limited objectives of this paper.

We take as a working hypothesis the postulation that, although the international recession necessarily entails adjustments that imply a relatively lower level of activity, there are various alternative options for dealing with the situation, which in fact has already been experienced by the countries of the region. These options are in part determined by the structural features of the individual economies, but they also depend on the policy package that is applied. In this context, wage policy comes to play an important part in short-run adjustments and in effect determines the distribution of the cost involved in the adjustment among the different groups of the population.

In addition, two other aspects will be dealt with. The first is the impact of the rise in interest rates on the Latin American economies, since as mentioned above, this is a new and distinguishing factor of the present crisis. The second is the adjustment of the labour market, because of its implications on income levels and distribution.

II
The external adjustment and wages

1. *The case of small open countries*

There is a first group of countries in the region which are of small size and have an openness coefficient (i.e., a ratio of exports to gross national product) of between 20 and 30%. They had these same structural features already in the 1930s, and when faced with the international crisis at that time they had to remain tied to the gold standard while waiting for the automatic adjustment to operate. On that occasion, they suffered a considerable cost as a result of not being able to design policies that would attenuate the effect of the international crisis. The present situation seems to be basically the same. The full impact of world recessions falls upon these economies, which must inevitably absorb the deterioration in the terms of trade and reduce real wages whenever an international situation of this sort occurs.

Central America and the Caribbean provide numerous examples of this type of economy, where the possibility of an autonomous policy is slight. In particular, if we examine the performance of Costa Rica and Honduras in the 1973-1975 crisis and in the present one, since 1979, we can see that in both countries the fall in the terms of trade has brought with it a decline in real wages. Thus, in Honduras the first recession implied a loss of around 6.3% in the growth rate of the product owing to the fall in the terms of trade and a reduction of 2.9% in industrial sector real wages during the same period. The present recession has meant up to 1981 a fall in the growth rate of the product of around 8.2% and an 8.1% drop in industrial real wages (see table 1).

In Costa Rica there are similar links between the negative effect of the decline in the terms of trade and the decrease in real wages during the two international crises. In this country there has also been a further reduction in real wages stemming from an upsurge of inflation in an economy that had not previously experienced high inflation rates. The 1973-1975 recession there coincided with an inflation rate of 25%, while in the present crisis the annual inflation rate averaged 30% between 1979 and 1981, the rate for the latter year being 65%.

2. *The case of medium-sized and large countries*

Already in the recession of the 1930s, and to an even greater extent in more recent international crises, the other countries of the region have displayed a certain degree of autonomy which has enabled them to a certain extent to reduce and control the impact of international crises of this magnitude. This group of countries comprises those of a larger size, generally less open to international trade and with a higher degree of urbanization and modernization. Hence, exports hardly exceed 10% of the product, the proportion of modern urban activities in employment reaches between 50 and 60% of the total labour force, and employment in modern industry comprises between 20 and 28% of the non-agricultural labour force. It is precisely in this group of countries that wages come to be a representantive variable, given the greater coverage of wage-labour as a direct result of the higher degree of modernization. Included in this group are the Southern Cone countries (Argentina, Chile and Uruguay), Brazil, Colombia, Mexico and Venezuela, among others.

By way of introduction, it is worth reviewing the performance of these countries in the crisis of the 1930s and the policies they applied.[1] In the first place, those Latin American countries that enjoyed some degree of autonomy went through this crisis at a lower cost than the other countries of the region and even than the United States and Canada. In general, they grew more rapidly than the latter two countries in the period following the crisis (1932-1939); they recovered sooner; their contraction was not so pronounced as in Northern

[1]The analysis of the performance of these countries and the policies followed during the 1930s crisis closely follows the work of C. Díaz-Alejandro: *Latin America in the 1930s* (New Haven, Yale University Economic Growth Center, 1981).

Table 1
EXTERNAL ADJUSTMENT, WAGES AND PRICES IN SOME LATIN AMERICAN COUNTRIES

(Percentages)

	Terms of trade [a]	Degree of openness [b]	Effect on product [c]	Purchasing power of exports [a]	Wages[a]			Domestic prices [d]
					Urban minimum	Indus-trial	Construc-tion	
Small open countries								
Costa Rica								
1973-1975	-9.2	27.6	-2.5	-7.1	-7.4	-9.0	-6.1	25.4
1975-1978	40.1	21.2	8.5	55.2	25.3	31.3	34.9	5.9
1978-1981	-29.2	21.8	-6.4	-10.5	-8.3	-12.2	-11.2	30.1
1973-1981	-9.8	23.5	-2.3	29.7	6.3	4.9	12.7	19.3
Honduras								
1973-1975	-23.1	27.1	-6.3	-20.2	-7.2	-2.9	-31.9	10.4
1975-1978	23.3	24.1	5.6	60.5	-15.6	12.0	77.5	6.2
1978-1981	-23.7	27.1	-8.2	-1.0	-6.2	-8.1	-24.4	14.3
1973-1981	-27.6	26.1	-7.2	32.2	-26.5	-	-8.6	10.2
Medium-sized and large countries								
Oil-dependent								
Brazil								
1973-1975	-21.2	6.9	-1.5	14.7	-2.3	12.1	6.9	32.5
1975-1978	2.6	6.2	0.2	24.7	3.5	13.3	12.0	42.0
1978-1981	-42.7	7.0	-3.0	6.3	1.1	8.1	-1.9	87.3
1973-1981	-53.7	6.5	-3.5	16.0	2.3	37.3	17.4	54.8
Relatively self-sufficient								
With substantial economic policy changes								
Argentina								
1973-1975	-30.0	5.5	-1.7	-45.9	-8.9	1.7	33.3	173.8
1975-1978	-19.2	9.2	-1.8	87.2	-50.4	-54.9	-55.9	211.5
1978-1981	-8.4	8.1	-0.7	-3.3	6.3	14.7	-3.2	118.2
1973-1981	-48.2	7.5	-3.6	24.0	-52.0	-20.6	-43.1	163.9
Chile								
1970-1975	-46.8	15.3	-7.2	-28.7	-41.1	-41.8	-18.3	233.1
1975-1978	-0.6	21.2	-0.1	27.1	29.9	44.3	4.2	80.1
1978-1981	-14.0	24.6	-3.4	13.7	-1.5	38.0	27.0	25.9
1970-1981	-57.2	20.4	-11.7	3.0	-24.7	15.9	8.1	98.9
Without substantial economic policy changes								
Colombia								
1973-1975	-19.9	14.8	-2.9	0.4	16.4	-8.0	7.3	22.3
1975-1978	64.7	7.4	4.8	51.7	9.4	13.3	5.1	24.2
1978-1981	-32.4	6.9	-2.2	-23.8	17.6	7.2	17.6	27.7
1973-1981	-7.4	9.7	-0.7	16.1	49.7	11.7	32.6	25.0
Oil-exporting countries								
Ecuador								
1973-1975	36.3	18.1	6.6	16.5	9.3	7.3	...	17.1
1975-1978	8.7	12.4	1.1	27.7	-8.0	8.4	...	11.6
1978-1981	31.1	11.4	3.6	28.1	111.3	22.9	...	13.7
1973-1981	94.3	14.0	13.2	96.0	112.5	43.0	...	13.7
Mexico								
1973-1975	3.6	7.3	0.3	2.5	16.9	8.6	5.8	15.8
1975-1978	12.2	7.0	0.8	82.3	7.9	8.0	9.1	21.3
1978-1981	47.6	7.4	3.5	140.6	-8.4	-1.7	1.6	26.1
1973-1981	71.5	7.2	5.1	349.8	15.6	14.0	17.3	21.7

Table 1 (Concl.)

	Terms of trade [a]	Degree of openness [b]	Effect on product [c]	Purchasing power of exports [a]	Wages[a]			Domestic prices [d]
					Urban minimum	Industrial	Construction	
Venezuela								
1973-1975	97.6	14.3	14.0	30.3	−9.3	13.1	...	9.8
1975-1978	−13.9	9.5	−1.3	−20.4	−19.6	2.1	...	7.3
1978-1981	114.2	8.1	9.3	77.2	17.7	−1.1	−5.2	17.8
1973-1981	264.4	10.6	28.0	102.3	−14.2	14.2	...	11.8

Source: Prepared by PREALC on the basis of national data.
[a] Changes between the initial and final year of each period.
[b] Relation between exports and gross domestic product.
[c] Obtained by multiplying the change in the terms of trade by the coefficient of openness.
[d] Annual cumulative rates referring to changes December to December.

America; and manufacturing industry, which became the leading sector in these economies, grew steadily at an annual rate of between 8 and 13%, whereas in the United States the manufacturing sector remained stagnant.

The policies pursued by this group of countries during the 1930s were characteristically heterodox, in defiance of the conventional prescriptions of monetarist experts of the time ('money doctors', as Carlos Díaz-Alejandro calls them). Concerning the balance of payments, there were currency devaluations and multiple exchange rate systems were established, with a higher rate for imports, a medium rate for exports and a preferential rate for servicing the external debt. Likewise, most of these countries renegotiated their debt unilaterally, only Argentina, Haiti and the Dominican Republic continuing to service the debt on its original terms. The effect of devaluation was not inflationary and helped to increase competitiveness through a change in the relation between the exchange rate and wages, basically through an increase in the former since the latter remained stable in real terms. These measures were accompanied by exchange controls and tariff adjustments that raised the level of protection.

The monetary and fiscal policies applied at that time had a clear expansionary effect. The real money supply increased, basically owing to the decline in nominal prices, and the stock of money was increased against bonds, independently of the gold standard that had been in force up to that time. In several countries, a moratorium on the internal debt was declared and financial institutions were supported to prevent bankruptcy by means of diverse measures ranging from special rediscount lines to, in some cases, the freezing of savings deposits. Fiscal policy acquired distinct anticyclical features: there was no attempt to balance the budget, and a deficit was maintained, basically financed by delays in payments and an increase in short-term borrowing. Likewise, public expenditure was increased in order to avoid a contraction of economic activity.

Finally, the combined effect of these measures was to produce a far-reaching structural transformation which still characterizes the economies of these countries up to the present and basically consisted of a rapid expansion of the manufacturing sector, together with a higher degree of State intervention in economic activity.

At present, the countries in this group have begun to develop differences owing chiefly to the different impact of oil prices in the more recent international crises. Hence, a distinction must be made between the oil-exporting countries, those which are largely dependent on imported fuel, and those which have some degree of autonomy because they are relatively self-sufficient. Ecuador, Mexico and Venezuela are among the oil-exporting countries, while Brazil is particularly heavily dependent on fuel imports. Finally, in the group of relatively self-sufficient countries a distinction must be made between those which in the past decade have applied structural policies of price stabilization and external openness (basically, those of the Southern Cone) and those which have pursued more conventional policies, such as Colombia.

3. *The oil-exporting countries*

These countries benefited from the rise in the price of oil, which caused a remarkable improvement in their terms of trade, combined in some cases, such as that of Mexico, with a considerable expansion in the export volume of this product. The improvement was particularly marked in the case of Ecuador, Mexico and Venezuela, which were able to apply a policy of real wage increases owing to the favourable international situation, so that a high correlation between the rise in the terms of trade and increases in real wages is observed (see table 1).

However, there was a growing tendency in these countries to overexpand domestic expenditure and to increase the money supply as a result of the aforesaid oil boom, resulting in accelerated inflation and/or balance-of-payments problems. These were paradoxical results, since these economies had historically exhibited low rates of inflation, while moreover their greatest boom in recent decades was followed by the emergence of a balance-of-payments deficit. They were thus compelled to resort to adjustment policies involving a reduction of expenditure and wage controls, as in Mexico and Venezuela since 1979. As a result, real wages tended to contract despite the improvement in the terms of trade.

Ultimately, although during the period 1973-1981 wages benefited from the oil boom, the actual benefits were diminished owing to the aforesaid internal disequilibria, especially inflation, whose effects were particularly negative because these economies had little previous experience of this problem and hence lacked systems of wage indexation. Thus, in Venezuela, despite an expansion of the order of 28% in the product due to improvements in the terms of trade, real wages in the industrial sector increased by only 14% during the same period.

4. *The non-oil-exporting countries*

a) *Countries dependent on oil imports*

By far the most important country in this group is Brazil, which is relatively autonomous in the design of its economic policy but is heavily dependent on oil imports. This country made active use of its possibilities of increasing the external debt in order to cushion the economy from the recessive impact caused by the pronounced fall in its terms of trade.

As a result of these policies, during the period 1973-1975 Brazil was able to raise industrial real wages by around 12%, even though the terms of trade fell by approximately 21%. With the further fall in its terms of trade from 1978 onwards, however, the growth in real wages has considerably slackened (see table 1).

It is clear that Brazil gradually lost flexibility in its handling of international crises both through the emergence of internal imbalances chiefly observable in the inflationary upsurge of recent years and through the greater cost associated with the increase in real interest rates, given its high degree of indebtedness. Thus, if the growth in the nominal interest rate applied by commercial banks to their best customers (prime rate) and in that applied to three-month deposits in Eurodollars is compared with the growth in the price of Brazilian exports, it will be seen that the former rose during 1978-1981 by 59% and the latter by only 43% (both in real terms). Given that 84% of Brazil's external debt has been contracted at variable interest rates and that it constitutes around 25% of the gross national product, and taking into account that the rate prevailing in 1978 was around 10%, it can be estimated that the rise in international interest rates has produced a deterioration of around 11% in the product, which is almost four times the deterioration in the product attributable to the fall in the terms of trade during the period 1978-1981.

Nevertheless, despite the unfavourable situation confronted by Brazil, analysis of the period 1973-1981 shows that, although this country had to face a deterioration in the terms of trade that implied a decrease in the rate of growth of the product of around 3.5%, the domestic policies applied not only protected wages from a similar reduction but actually permitted a rise of around 37% in the average real wage paid in the industrial sector. This is undoubtedly a clear illustration of policies capable of coping with the international recession without shifting the burden of the adjustment primarily on to wages. It is still too early, however, to evaluate the net effect, since this country must face up to a heavy external debt which was, in fact, one of the factors that made possible the economic policy approach adopted.

b) *Countries not dependent on oil*

i) *Countries without substantial changes in economic policy.* A case that illustrates this type of situation is Colombia. Its terms of trade were adversely affected both in the 1973-1975 crisis and in that beginning in 1978. Notwithstanding the negative impact of the international situation, the economic policies adopted fostered an expansion in the quantum of exports and thus neutralized the adverse effect of international prices, at the same time permitting a significant rise in real wages during the period 1973-1981. Thus, in contrast with a potential decline in the product of around 1%, attributable to the decline in the terms of trade, urban minimum wages rose by 50%, industrial wages by 12% and those in construction by 33% (all in real terms) over the same period (see table 1).

ii) *Countries with marked changes in economic policy.* This group includes Argentina, Chile and Uruguay,[2] which during the decade pursued policies of price stabilization and external openness of their economies. It is outside the objectives of this paper to comment here on these policies or on their main effects.[3] We shall concentrate instead on the degree of autonomy of these countries regarding the taking of domestic economic policy decisions and on the consequences of the policies adopted.

First, the fact that these countries possess some degree of autonomy in their economic-policy decisions and are not entirely subject to international fluctuations is clearly illustrated by the case of Argentina, which during the 1973-1975 crisis succeeded in at least maintaining wages in real terms, despite a deterioration in its terms of trade of around 30%. Similarly, Chile in the recession beginning in 1978 succeeded in preventing the deterioration in the terms of trade from being transferred to wages. It should be noted in this latter case that the increase in real wages during the more recent period was largely due to the slowdown in the inflation rate, which in an indexed economy automatically amounts to a rise in real wages.

Secondly, wages became a basic variable in the economic and social policies adopted by these countries. Wage control was a basic policy instrument in the effort to achieve price stabilization and an improvement in international competitiveness, especially during the quite long periods when fixed exchange rate policies were applied (or, more generally, overvaluation of the local currency), when it was sought to achieve, by reducing wages, a shift of resources towards the production of tradeables. Wage control was also used as a social objective for disciplining the labour force, since in both countries it was sought by this means to avoid pressures that might challenge the economic and political decisions being applied. In particular, this economic strategy resulted in a disarticulation of the trade-union movement, basically through the anti-industrial and anti-employment bias introduced by the policy.[4] This made possible effective reductions in real wages without major resistance arising within the system.

The result of these policies was a reduction in wages that apparently exceeded the cost that would have been involved in absorbing the deterioration of the terms of trade. Thus, in Argentina between 1973 and 1981 the decline in the terms of trade implied a reduction in the growth rate of the product of around 3.6%, but wages in the industrial sector fell during that period by around 21%. In Chile between 1970 and 1975, the negative effect of the terms of trade implied a fall in the product of around 7%, but industrial wages contracted during that period by over 41% (see table 1).

In both countries, however, real industrial wages rose between 1978 and 1981 in spite of a deterioration in the terms of trade. This wage

[2]It should be noted that the three countries have different degrees of dependence on imported oil. Argentina is practically self-sufficient, while Uruguay is highly dependent. Chile's position is intermediate.

[3]See, for example, PREALC: *Políticas de estabilización y empleo en América Latina*, Investigaciones Sobre Empleo Series, No. 22 (Santiago, PREALC, 1982).

[4]R. Lagos and V.E. Tokman: *Global monetarism, employment and social stratification*, Trabajos Ocasionales Series, No. 47, Rev.1 (Santiago, PREALC, 1982).

behaviour conceals the real effect of the policies followed, for various reasons. The first is that 1981 was a year in which wages were at their maximum, but only temporarily, since real industrial wages fell during 1982 by 10.5 and 3% in Argentina and Chile, respectively. The second reason is that the adjustment operated mainly through reductions in the levels of total employment, especially that in manufacturing industry, rather than through reductions in wages. Manufacturing employment in Argentina fell in absolute terms between 1973 and 1981 by 32.8% (37.2%, if 1982 is included) and by 21.2% between 1978 and 1981 (26.2%, if 1982 is included). In Chile, the reduction between 1970 and 1981 was around 17% (28%, if 1982 is included) and 8% between 1978 and 1981 (20.4%, if 1982 is included). Lastly, in the particular case of Chile, the adjustment implied a substantial increase in the rate of open unemployment and in occupations in emergency programmes at remunerations of around one-third of the minimum wage. Open unemployment, including this minimum employment, increased fivefold between 1970 and 1981 and reached 28.4% of the labour force in 1982.

5. *Tentative conclusions*

To sum up, the experience of different countries in the region suggests that, although in the face of adverse international developments the countries have no option other than to adjust their economies, and that this implies adopting policies that result in a fall in real wages, this occurs automatically only in a small group of countries which, because of their size and degree of openness, do not possess the autonomy to alter this result.

There are, however, numerous countries in the region that have in the past shown a certain degree of autonomy and have controlled the domestic adjustment to international recessions by influencing the distribution of the cost of adjustment, the period during which it is applied and, finally, the different mechanisms through which their economies adjust to external crises. Experience also shows that some countries have succeeded in applying an expansive wage policy during adverse international conditions, just as there are others which, in similar circumstances, have accentuated the cost of adjustment by introducing substantial changes in their economic policies. Finally, the oil-exporting countries are a special case in which, although it is possible in principle (and so it has been done) to pass on the international bonanza in the form of real wage increases, internal and sometimes external imbalances arise that eventually limit this possibility, so that finally wages actually expand less than would have been theoretically feasible.

In short, the economic history of the last five years points to the failure of two kinds of policies: the contractionary global monetarist policy followed in the Southern Cone, and the expansive policy of the oil-exporting countries. The more eclectic models followed by other countries, although markedly different from each other, seem to have been more effective in reducing or at least postponing, the cost of the adjustment and distributing it in a more equitable manner.

III

The increase in international interest rates

The present world recession differs from earlier ones in that it has not only produced a major fall in the region's terms of trade but also been accompanied by a rise in the interest rate applicable to the external debt service. Thus, between 1978 and 1981 the rate applicable to best debtors by North American banks (prime rate) rose by 72.3% and the rate applicable to three-month deposits in Eurodollars rose by 54.9%.

This considerable increase in nominal interest rates entails an additional outflow of financial resources for the countries of the re-

Table 2

EFFECT OF THE CHANGE IN INTERNATIONAL INTEREST RATES, 1978-1981

	$\frac{i_1}{P_x}$ (1)	$\frac{i_2}{P_x}$ (2)	$\frac{i_1}{Pi/t_c}$ (3)	$\frac{i_2}{Pi/t_c}$ (4)	Percentage of the external debt: With respect to the gross national product[a] (5)	Percentage of the external debt: Subject to variable interest rates[b] (6)	Loss of growth due to interest rate rises[c] (7)	Ratio of loss of growth due to interest rate rises to terms-of-trade effect[d] (8)
Argentina	5.9	17.8	–57.3	–47.5	41.1	80.0	–3.9	5.6
Brazil	42.9	58.9	26.1	40.3	24.9	84.0	–10.7	3.6
Chile	22.1	35.8	–14.4	–4.8	35.6	65.6	–6.8	2.0
Colombia	68.1	86.9	7.2	19.2	22.8	58.3	–10.3	4.7
Costa Rica	56.0	73.6	99.4	125.5	49.3	62.4	–19.9	3.1
Honduras	49.9	66.7	8.0	20.2	59.6	45.8	–15.9	1.9

Source: Prepared by PREALC on the basis of information from the countries.

i_1 = variation in the interest rate on Eurodollar deposits for 90 days.
i_2 = variation in the prime interest rate.
P_x = changes in export prices.
P_i = changes in domestic prices.
t_c = changes in the exchange rate.

[a] Refers to 1980.
[b] Refers to the average for the period 1978-1980.
[c] Calculated by applying the mean variation in the real interest rate (1) and (2) to the percentage of the debt with respect to the product (5), adjusted by the percentage of the debt subject to variable interest rates.
[d] Relation between (7) and the loss due to the terms of trade as estimated in table 1.

gion. It has been estimated that in 1981 each additional percentage point on the nominal interest rate implied an increase in interest payments of US$ 2 250 million for the region as a whole. This amount is equivalent to 2.6% of the value of Latin America's exports of goods, reaching a proportion of 3.3% of total annual export value in the case of Mexico and around 3% in that of Argentina and Brazil.

To assess the pressure on resources implied by this increase in the nominal interest rate, it must be compared with the evolution of export prices in the region during the same period. When this is done, the situation becomes more diversified, according to the particular features of each country. In the case of the region's oil-exporting economies, their export prices grew faster than the increase in the nominal interest rate during the period, and the variation in the real interest rate has consequently been negative. In the remaining countries of the region, the effect of the change in the real interest rate has affected growth of the product differently according to the evolution of export prices, the ratio of the external debt to the gross national product, and the proportion of the debt contracted at variable interest rates.

Firstly, there is a group of countries where the rise in nominal interest rates was combined with a fall in export prices, at the same time that the external debt amounted to a high percentage of the gross national product. This is typically the case of the Central American economies, among them Costa Rica and Honduras. As a result of the rise in real interest rates[5] the growth possibilities diminished by 20% in Costa Rica and by 16% in Honduras during the period 1978-1981 (see table 2). Secondly, there is another group of countries where the rise in nominal interest rates was

[5]The method used to calculate this effect consisted of estimating the proportion of the debt subject to variable interest rates in relation to the gross domestic product and applying to this coefficient the rate of growth of the interest rate in real terms, defined as the variation in the international interest rate, deflated by the variation in the export prices of the respective country.

combined with virtually stationary export prices and the burden of the external debt as a proportion of the national product is around 25% but it is largely contracted at variable interest rates. This group includes Brazil and Colombia, where the effect of the potential loss of growth of the product was around 10% during the same period. Finally, we have a group of countries in which the increase in nominal interest rates was largely offset by an improvement in export prices, but which nevertheless exhibit a heavy burden of external debt as a percentage of the national product (of the order of 40%), with around 80% of the debt contracted at variable interest rates. This is the case of Argentina and Chile, with a potential loss of growth of the product of 4% in the former and 7% in the latter.

On the other hand, to gain an approximate idea of the effect of the rise in real interest rates as compared with that attributable to the deterioration of the terms of trade, it is convenient to relate both effects to the potential growth of the national product. This shows that during the period 1978-1981 the size of the effect associated with real interest rates varied among different countries from 1.9 to 5.6 times the terms-of-trade effect. At one extreme we find Argentina and Colombia, where the real interest-rate effect is around five times that linked with the terms of trade. They are followed by an intermediate group including Brazil and Costa Rica, where the effect of the former is around three times that of the latter, and a third group, made up of countries like Chile and Honduras, where the difference is around two to one (see table 2).

Lastly, it should be noted that the most significant change in the structure of the region's external debt in recent years has been the increase in the proportion of private funds in the total, both as regards their origin and their destination. There has been a particularly sharp increase in the proportion of private sector credits without public sector guarantee. This has brought about a change in the characteristics of the external indebtedness, which is increasingly contracted at variable interest rates (85% of the total by 1981), thereby making the economies more vulnerable to the variations in interest rates on the international markets.

From a distributive viewpoint, the effect of the rise in the international nominal interest rates should be related to the evolution of those particular prices which are significant for national private borrowers. For them, the relevant prices are given by the changes in domestic prices in relation to the changes in the exchange rate. From this comparison, it will be seen that the effect of the rise in nominal interest rates has not in general been passed on to the national private borrowers, since most of the countries in the region exhibit either a fixed exchange rate with increases in domestic prices, or exchange-rate depreciation lagging behind domestic inflation.

Clear example of fixed exchange rates with domestic inflation are provided by the oil-exporting countries, especially Mexico and Venezuela, together with small and open economies such as Honduras, which also maintained a fixed exchange rate against upward variations in domestic prices. From the standpoint of those who incur debts in dollars, this results in a negative real interest rate. The same has occurred in Argentina and Chile, since both countries applied during this period stabilization policies which made use either of a fixed exchange rate or lagging devaluation as instruments for reducing inflationary pressures. In these two cases, the real interest rate for dollar debtors is also negative. In Brazil and Colombia, where lags in foreign-exchange-rate depreciation are also found, but to a lesser degree than in the countries mentioned before, the effect was to reduce the increase in the real interest rate by about a half in Brazil and by one ninth in Colombia. Lastly, there are countries such as Costa Rica, where the rise in nominal interest rates has been combined with an appreciation in real terms of the exchange rate, this resulting in a positive real interest rate that is higher for the private debtor than for the country as a whole.

In sum, it is clear that the rise which has recently occurred in international nominal interest rates amounts to an additional substantial burden for the countries of the region, which at the same time are being forced to adjust their economies to a recessive situation. Nevertheless, on analysing the effect of the rise of interest rates in real terms, the situations of particular countries are found to differ according to the evolution of their export prices, the weight of the debt in relation to the national product, and the proportion of the debt subject to variable interest rates. Finally, the actual incidence of the increase in nominal interest rates upon the national private sector depends on the exchange policy applied in each country and on the evolution of domestic prices, the result being in most cases a lesser burden than that determined by the variation in the interest rate in the international financial markets, while in some countries this has even been transformed from a burden into a subsidy.

IV

The economic adjustment and the labour market

It is increasingly argued that higher real wages are one of the principal factors behind the growth of open unemployment. This line of argument, whose theoretical basis is highly questionable in view of the assumptions put forward to justify it, is not borne out by the existing data.

On analysing the variation in wages (whether the urban minimum, those in manufacturing industry or in construction) in relation to the changes in open unemployment during two sub-periods of the past decade, the results clearly show that no such relationship exists. The information on 12 Latin American countries for the periods 1975-1978 and 1978-1981, selected because of the different international situation prevailing in each one, clearly confirms this assertion (see table 3).

Thus, during the first period only in one country (Venezuela) was the fall in urban minimum wages accompanied by a significant decrease in the rate of open unemployment. Even in this case, however, this relationship no longer holds good in connection with the change in industrial wages. Moreover, there is no country where an increase in real wages is seen to be associated with a significant rise (over one percentage point) in open unemployment. On the contrary, in 6 out of the 12 countries considered we find the opposite association, that is to say increases in real wages accompanied by significant decreases in the rate of open unemployment rate or decreases in the former together with a significant rise in open unemployment.

In the period 1978-1981 only two countries show a simultaneous fall in real wages and in open unemployment when both urban minimum wages and industrial wages are considered. Similarly, if we analyse movements in the same direction (i.e., increases in real wages together with increases in open unemployment) the number of cases observed is three for the urban minimum wage, but there is no significant case in relation to wages in industry and construction. In contrast, there is a greater number of countries showing opposite movements in real wages and the rate of open unemployment, whatever the type of wage considered.

This scanty relation between changes in the real wage and changes in open unemployment, and indeed the observation of considerable evidence to the contrary, points to the need to investigate the likelihood of other determinant factors. In particular, changes in the level of economic activity can induce variations in the open-unemployment rates. This statement is based not only on an important current of theoretical interpretation but also on the available evidence for short-term variations, which seems to suggest the existence of a high correlation of this sort. On relating information on the growth of the gross domestic product with changes in the rate of open unemployment (see table 3), it is observed that in the period 1975-1978, in 5 of the 12 countries for which information is available there was a positive correlation between accelerated growth and decreases in the unemployment rate, or between a contraction in the product and an increase in the unemployment rate. Again, in the period 1978-1981, in 5 of the 12 countries considered this relationship holds good. It is clear, then, that

Table 3
LATIN AMERICA AND THE CARIBBEAN: REAL WAGES ACTIVITY LEVELS AND OPEN UNEMPLOYMENT

	1975-1978					1978-1981				
	Growth of product[a]	Changes in wages[b]			Changes in open unemployment[c]	Growth of product[a]	Changes in wages[b]			Changes in open unemployment[c]
		w_m	w_i	w_c			w_m	w_i	w_c	
Argentina	1.6	−50.4	−54.9	−55.9	0.2	0.2	8.9	19.9	−	0.7[d]
Brazil	6.6	3.5	13.3	12.0	0.6	3.5	−10.2	−6.3	−15.5	1.7[e]
Colombia	6.1	9.4	13.3	5.1	−2.0	4.1	20.3	7.4	14.3	−0.8
Costa Rica	6.9	25.3	31.3	34.9	0.4	0.6	1.8	0.7	1.4	3.3
Chile	7.2	30.0	20.6	44.4	−1.7	6.7	−0.6	18.1	23.6	−4.3
Jamaica	−2.1	−17.2[f]			4.0	−3.8[d]	−12.0[f]			5.0[d]
Mexico	6.6	7.9	8.0	−	−0.3	8.5	−9.0	−5.7	−	−2.4
Panama	3.6	−11.7	−	−11.7	1.0	5.0	2.1	−	−2.5	2.0[g]
Peru	0.5	−32.0	−27.4	−38.6	0.5	3.9	13.8	2.6	2.6	−1.2
Trinidad & Tobago	9.9	8.8[f]			−1.7	4.9[d]	5.1[d]			1.8[d]
Uruguay	4.1	−16.8	−26.3	−25.9	1.6	4.1	−15.1	−15.0	−13.6	−3.4
Venezuela	6.1	−19.6	2.1	−	−3.2	−0.1	−3.0	−12.8	−	1.9

Source: PREALC figures on the basis of information from the countries.
[a] Annual growth rates.
[b] w_m : urban minimum wages.
w_i : wages in manufacturing industry.
w_c : wages in construction. Percentage variation during the period.
[c] Changes, in percentage points, between the first and the last years.
[d] Refers to 1978-1980.
[e] Preliminary estimate.
[f] Refers to total wages.
[g] Refers to 1978-1979.

there is in the short run an appreciable degree of correlation between the level of economic activity and the rate of open unemployment, though in some cases a high growth rate is associated with a constant unemployment rate.

The preceding analysis consequently suggests that the open-unemployment rate appears to be more responsive to changes in the activity level than to variations in real wages. However, the possibility of explaining changes in the labour market through the mere observation of variations in open unemployment is indeed limited for economies like those of the region, where there is a significant amount of underemployment. Adjustment in heterogeneous labour markets may take various forms: changes in open unemployment, variations in underemployment or a combination of both. Let us illustrate the reaction of the labour market to a recessive conjunction by looking at four Latin American countries presenting different conditions.

For this purpose, we chose Argentina in the period 1974-1980, Chile during the past decade, and Venezuela and Costa Rica as from 1978. The first two cases were selected because they combine external adjustment with profound changes in economic policy, mainly directed towards achieving price stabilization and a higher degree of openness. The third case illustrates the experience of an oil-exporting country combining an oil boom with economic policies aimed at correcting some internal disequilibria mainly reflected in an upsurge of inflation compared with previous historial patterns. The last country illustrates the case of a small open economy facing balance-of-payments problems and inflationary pressures.

As may be seen from table 4, the four cases present common features. On the one hand, the rate of growth of the product is low, and even negative in Venezuela. On the other hand, all these economies exhibit inflationary problems, though in differing degrees. In Costa Rica and

Table 4
LATIN AMERICA: THREE TYPES OF LABOUR MARKET ADJUSTMENT

	Annual rate of growth of product (%)	Annual rate of growth of prices (%)	Variation in real wages over whole period (%)	Changes over whole period in: Open unemployment (*Percentage points*)	Share of urban informal sector	Annual growth of non-agricultural EAP (%)	Ratio of incomes in the informal sector to modern sector[a]
Case 1							
Argentina (1974-1980)	1.9	156.3	−46.9[b]	− 0.3	4.0	0.6	1.03
Case 2							
Costa Rica (1978-1981)	0.6	30.1	−11.2	3.7	−0.1	5.2	0.71
Chile (1970-1980)	2.7	79.1	−21.4	14.5[c]	0.1	2.7	0.73-0.80
Case 3							
Venezuela (1978-1981)	−0.6	16.9	− 6.7	2.3	3.0	4.5	0.86

Source: Prepared by PREALC on the basis of national statistics.
[a] Because of the difficulty of obtaining income data disaggregated by sectors, the definitions are not exactly identical in the four cases, but they represent acceptable approximations.
[b] Wages in manufacturing industry.
[c] Includes those occupied in the Minimum Employment Plan (PEM).

Venezuela, although the price increases might be considered relatively moderate, the annual rates registered were four and even five times as high as the historic inflation rate. Finally, during the periods under analysis, real wages are seen to decline in all four cases. These common features reflect in fact similar economic policy decisions designed to control domestic demand and wages with a view to reducing price increases.[6]

However, the labour market reacted quite differently in each case. In Argentina, the adjustment took place via an increase in the proportion of those employed in the urban informal sector, while the open-unemployment rate remained virtually constant throughout the period. In Chile and Costa Rica, on the contrary, the adjustment proceeded almost entirely through a rise in the open-unemployment rate, while the proportion of the urban informal sector remained constant. The labour market in Venezuela, for its part, adjusted in an intermediate manner, showing a rise both in the open-unemployment rate and in the proportion of those employed in the urban informal sector. The first of these cases illustrates an adjustment entirely achieved by way of an increase in underemployment; in Chile and Costa Rica there was an increase in open unemployment; and in Venezuela the adjustment operated through both open unemployment and underemployment.

At this point, one might ask what it is that determines these distinctly different types of adjustment in the labour market. Given the similarity between the four countries under analysis in respect of the magnitude of the informal sector, the difference might be traced to the average level of income prevailing in this sector. Both in Argentina and in Venezuela, the average income obtained by informal workers is only slightly different from that corresponding to occupations in modern activities. In Chile and Costa Rica, however, the difference is as high as 30%. This seems to imply that those who are unable to find work in the modern sector because of the adjustment in the labour market prefer to remain in active search for a job when the other employment opportunities open to them would

[6]It should be noted that the capacity of changes in real wages and in the level of activity to provide useful explanations when analysing variations in open unemployment is extremely limited, and indeed they often give contradictory answers. Thus, although real wages went down in all four cases, the rate of unemployment remained unchanged or went up in all cases.

entail a considerably smaller income. In contrast, when the difference is not so marked the option of working in the informal sector until the labour market becomes normal appears a valid alternative.

Finally, it is interesting to compare the adjustment of the labour market in developing countries like those analysed above with a developed country, say, the United States during the same period. For this country, the data show that the non-agricultural population grew by 2.8% per year between 1978 and 1981, the number of unemployed rose by 10.5% per year, and the non-professional self-employed and unpaid family workers diminished by 6.3% per year. It is clearly a case of adjustment through increases in the open unemployment rate. Since income differentials in the United States are small, or at any rate smaller than in Argentina and Venezuela, one would have *a priori* expected also an expansion of non-wage occupations, but the real difference lies in the existence of an unemployment insurance which in the United States covers more than 40% of the unemployed. For these people, unemployment does not mean zero income, since they receive a guaranteed income while actively searching for new jobs.

Apart from illustrating differences in types of adjustment of the labour market, the comparative analysis made above suggests that the distributive effects in each case are different. Thus, the existence of unemployment insurance with wide coverage at normal income levels minimizes the direct effect on the distribution of income. At the other extreme, an increase in the number of unemployed without any welfare aid, as in Chile and Costa Rica, leads to a drastic deterioration in the distribution, while the intermediate cases of adjustment through expansion of less remunerated occupations also affect negatively the distribution of income, albeit in a milder way. In this latter case, the reduction of the average income of the self-employed plays the role of a collective unemployment insurance, constituting in practice a second-best solution from a welfare point of view.