

Distr.
Limited

LC/L.668
24 January 1992
ENGLISH
ORIGINAL: SPANISH

CEPAL
ECONOMIC COMMISSION FOR LATIN AMERICA AND THE CARIBBEAN

**SOCIAL EQUITY AND CHANGING PRODUCTION PATTERNS:
AN INTEGRATED APPROACH**



UNITED NATIONS

CONTENTS

	<i>Page</i>
INTRODUCTION	xi
SUMMARY	1
1. Introduction	1
2. A single task: the integrated approach	1
3. Central elements of the integrated approach	2
a) Technical progress	2
b) Productive employment	3
c) Investment in human resources	4
4. Two basic features of the ECLAC proposal	4
a) Institutional changes	4
b) The special features of the region and of each country	5
5. Main aspects of policies to promote the integrated approach	5
a) Technical progress and interaction with the international economy	5
b) The saving and investment process	6
c) Labour markets: participation and consensus-building	7
d) Social policy: investment in human resources and transfers	8
e) Participation, changing production patterns and social equity	9
6. Factors conditioning the integrated approach	9
a) The international scenario	9
b) Stabilization	10
c) Restructuring the State	10
7. A feasible task	11
Notes	11

	<i>Page</i>
Chapter I	
EROSION OF SOCIAL EQUITY	13
1. The post-war period	13
2. The 1980s	14
a) Population	15
b) Employment and productivity	19
c) Income distribution and poverty	24
d) Social services	24
e) Natural resources	29
f) Final remarks	33
Notes	34
Chapter II	
THE INTERNATIONAL SCENARIO	35
1. Introduction	35
2. The globalization of economic activity	35
3. Alternative scenarios for the world economy	36
4. The present situation of the world economy and outlook for the medium term ...	37
a) Trade regulations	37
b) The international context and resources for development	45
c) Trends shaping the world economy	49
Notes	51
Chapter III	
ECONOMIC STABILIZATION	53
1. The turnaround in the transfer of resources, the fiscal deficit and rising inflation	53
2. The costs of high inflation in terms of production and distribution	54
3. The lessons of the 1980s and their implications for changing production patterns with social equity	58

	<i>Page</i>
4. The implementation of a stabilization programme at a minimum recessionary and distributive cost	60
a) Controlling aggregate demand	60
b) Keeping expectations in check	67
c) Correcting relative prices	68
d) Compensatory distributive policies	70
e) Institutional reforms	71
f) The longer-term perspective	71
Notes	72
Chapter IV	
STRENGTHENING OF PUBLIC FINANCES	75
1. Preliminary remarks	75
2. The components of progressive fiscal reform	75
3. Tax reform and equity	77
a) Increasing the tax burden	77
b) Improving the equity of the tax structure	81
c) The feasibility of tax reforms aimed at improving equity	82
4. The restructuring of public expenditure	82
a) Reallocation of public expenditure to the social areas	84
b) Improvement of the efficacy and equity of social expenditure	86
5. Other ways of raising income and reducing public expenditure	91
Notes	97
Chapter V	
TECHNICAL PROGRESS AND INTERNATIONAL COMPETITIVENESS	99
1. Introduction	99
2. Technical progress and international competitiveness	101
a) The pattern of technical progress	101
b) Incorporation in the international economy and competitiveness: competitive position and efficiency	102

3. Policies for changing the structure of production	110
a) Sectoral policies	111
b) An export bias	111
4. Policies relating to the absorption of technical progress	113
a) Strengthening of enterprises	113
b) Strengthening the technological infrastructure	120
c) Strengthening production linkages	122
Notes	128

Chapter VI

INCOME AND THE PRODUCTIVITY OF LABOUR	131
1. Introduction	131
2. Training	131
a) The promotion of active corporate training policies	133
b) The generation and support of a demand for training in marginal or vulnerable sectors	134
c) Opportunities for financially self-sustaining training	135
d) The costs of training	135
3. Increased participation of the secondary labour force	136
4. Modernizing labour relations: profit-sharing schemes	139
5. Environmental conditions favourable to labour productivity	150
Notes	151

Chapter VII

SAVINGS AND THE PRODUCTIVITY OF CAPITAL	155
1. Introduction	155
2. The need for workers to save more	156
a) Institutional saving by workers	157
b) Savings and capital formation in the low-income housing sector	159

	<i>Page</i>
3. Creating a capital market for investment in education and training	163
4. Funding for investment projects in small and medium-scale enterprise	165
a) Leasing as a financing option	166
b) Loan security funds and collective loan guarantees	166
c) Technical assistance as a means of promoting lending to small businesses	168
d) Investment instruments	169
e) Business credit cards	171
5. Improving the land market	171
Notes	175
 Chapter VIII	
INVESTMENT IN HUMAN RESOURCES	179
1. Introduction	179
2. Population policy	179
3. Mother and child health programmes	183
4. Education	191
a) The regional situation	191
b) Policies for educational reform	197
c) Economic and political viability	208
Notes	209
 Chapter IX	
SOCIAL SECURITY AND TRANSFER POLICIES	211
1. Poverty, social equity and transfers	211
2. Social security programmes	212
a) The lack of equity in current systems	216
b) Expansion and quality of coverage	219
c) Social insurance and social welfare	221
d) Proposed reforms	222

	<i>Page</i>
3. Transfer programmes	223
a) Emergency employment programmes	223
b) Social investment funds	227
c) Transfers to combat chronic poverty: minimum household income	228
Notes	231

Chapter X

EMPOWERMENT, CHANGING PRODUCTION PATTERNS AND SOCIAL EQUITY . .	233
1. Introduction: the challenges of democratization	233
2. Empowerment and social equity	233
3. Inequality of social agents and their relationship with the State	234
4. Decentralization and small-scale problems	236
5. Courses of action	240
a) Social agents and their relationship with the State	241
b) Courses of action to address the problem of scale	246
Notes	249

BOXES

Box I-1	Population growth and poverty	17
Box I-2	Migrations, remittances and saving	18
Box III-1	The costs of inflation and the risk of a stabilization-induced recession	56
Box III-2	Heterodox stabilization programmes	61
Box III-3	Means of complementing economic policy during the stabilization process . .	62
Box III-4	Implementation of a fiscal adjustment	64
Box IV-1	The campaign against tax evasion in Chile	83
Box IV-2	Limitations of social expenditure policies	89
Box IV-3	Some forms of privatization in the telecommunications sector	95

	<i>Page</i>
Box V-1 Technological support institutions in South-East Asia	112
Box V-2 Policy governing the automotive industry in Mexico	113
Box V-3 The informatics policy in Brazil	114
Box V-4 Excellence in quality and investment in the exterior: Metal Leve, S.A.	116
Box V-5 Large foreign investments by Mexican producers of glass and cement	117
Box V-6 The international expansion of Petróleos de Venezuela, S.A. (PDVSA)	118
Box V-7 CONACYT (Mexico) programmes in support of technological development	123
Box V-8 Peru: cooperation in biotechnology and potato-growing	123
 Box VI-1 Retraining for workers displaced by the retrofitting of industry in Mexico	 136
Box VI-2 A training programme for young people in Chile	137
Box VI-3 A dual-track training programme for young people in the Dominican Republic	137
Box VI-4 Cases of profit-sharing in Brazil	147
Box VI-5 Profit-sharing in Chile	148
 Box VII-1 Chile's experience with prior savings requirements and demand-side housing subsidies	 162
Box VII-2 Leasing and small and medium-scale enterprise in Chile	167
Box VII-3 Ecuador's National Reciprocal Guarantee System	168
Box VII-4 The Banco de México's agricultural trust funds	170
Box VII-5 The land market and access to land	174
Box VII-6 Investment in irrigation, employment and social equity	175
 Box VIII-1 Adolescent pregnancy	 185
Box VIII-2 Population policies: various roads towards the lowering of fertility in Latin America	186
Box VIII-3 The <i>Escuela Nueva</i> : a national-level experiment in personalized education	201
Box VIII-4 Systems for measuring the quality of basic education. Some regional experiences	204
Box VIII-5 The learning process and the social-cultural level of the family	205
Box VIII-6 The Logos II programme for training teachers	207
 Box IX-1 Typology of levels of development of social security systems	 217
Box IX-2 The expansion of coverage to rural sectors	220
Box IX-3 Estimate of the impact of emergency employment programmes on poverty	225

	<i>Page</i>
Box X-1 Colombia, Act No. 11 of 16 January 1986: a case of administrative decentralization with the emergence of democracy	238
Box X-2 Social development funds as a tool for strengthening the role of non-governmental organizations in policies to help the poor: a preliminary overview of the region	242
Box X-3 Social equity and the synergetic effects of telematics	243
Box X-4 The <i>campesino</i> and indigenous movement in Ecuador: a case of organized community action in rural areas	245

INTRODUCTION

Two years ago, the secretariat of ECLAC put forward a proposal for the development of the Latin American and Caribbean countries in the 1990s entitled *Changing Production Patterns with Social Equity*.¹ This proposal, which marked a milestone in a process of analysis and reflection that had begun long before,² was submitted to the Economic Commission for Latin America and the Caribbean at its twenty-third session and was discussed at length on that occasion.³

The proposal was originally conceived as part of an ongoing process involving the re-working of thoughts and ideas, rather than as a final product. In fact, however, it became the central point of reference for the thinking of the institution and, hence, a source of inspiration for the work carried out by the secretariat in preparation for the twenty-fourth session of the Commission.⁴

During the 1990-1991 biennium, the secretariat focused its attention on certain aspects of the proposal which had not yet been developed fully. Some of the main such aspects were the role of social policy in changing production patterns with social equity,⁵ more detailed guidelines for the incorporation of a concern for the environment into the development process,⁶ the substance of an educational strategy geared to changing production patterns with social equity,⁷ and the role to be played by economic integration in the next stage of Latin American development.⁸

In accordance with the mandate it received at the twenty-third session, in this document the secretariat has attempted to delve further into the links among technical progress, international competitiveness and social equity, although it does not, certainly, purport to have exhausted these subjects.

Two qualifying remarks are called for here. First, the secretariat is deliberately abstaining from becoming embroiled in the theoretical aspects of a controversy which has raged for centuries, and particularly since the French revolution, i.e., the debate surrounding the cause-and-effect relationships and possible areas of incompatibility among democratic governance, economic stability, growth and well-being. Rather than concerning itself with doctrine, the secretariat prefers to deal with the realities confronting virtually all the Governments of the region. These realities include the need to resume a sustained (and environmentally sustainable) growth process within the framework of the consolidation of pluralistic, democratic societies —societies that are faced with very real demands to address the many ways in which the majority of the population has been bypassed by development.

Secondly, no attempt has been made in this document to provide a list of suitable policies for changing production patterns or for attaining greater social equity. Instead, the focus is on how certain pivotal analytical and policy aspects can be linked within an integrated approach so as to reinforce any existing areas of complementarity between efforts to achieve greater growth and efforts to seek greater social equity. This approach highlights the central tenet of the document: that growth, social equity and

democracy can be compatible. What is more, there are significant but as yet largely unexplored areas in which social equity and changing production patterns complement and reinforce one another.

Notes

¹ ECLAC, *Changing Production Patterns with Social Equity. The Prime Task of Latin American and Caribbean Development in the 1990s* (LC/G.1601-P), Santiago, Chile, 1990. United Nations publication, Sales No. E.90.II.G.6.

² For background on both recent and more remote developments in this regard, see ECLAC, *Change and Crisis: Latin America and the Caribbean 1950-1984* (LC/L.332(Sem.22/3)), Santiago, Chile, 1985; *Latin American and Caribbean Development: Obstacles, Requirements and Options* (LC/G.1440-P), Cuadernos de la CEPAL series, No. 55, Santiago, Chile, 1987; and *Towards Sustained Development in Latin America and the Caribbean: Restrictions and Requisites* (LC/G.1540-P), Cuadernos de la CEPAL series, No. 61, Santiago, Chile, 1989.

³ The proposal received widespread support from the member Governments. See ECLAC, *Biennial Report. Official Records of the Economic and Social Council, 1990, Supplement No. 14* (LC/G.1630-P; E/1990/43), Santiago, Chile, 1990; in particular resolution 507(XXIII), *Changing Production Patterns, Social Equity and the International Development Strategy*.

⁴ Santiago, Chile, April 1992.

⁵ See ECLAC, *Panorama Social de América Latina. Edición 1991* (LC/G.1688), Santiago, Chile, October 1991, and ECLAC, *La equidad en el panorama social durante los años ochenta* (LC/G.1686), Santiago, Chile, October 1991.

⁶ See, for example, ECLAC, *Sustainable Development: Changing Production Patterns, Social Equity and the Environment* (LC/G.1648/Rev.2-P), Santiago, Chile, 1991. United Nations publication, Sales No. E.91.II.G.5.

⁷ ECLAC/UNESCO, *Education and Knowledge: Basic Pillars of Changing Production Patterns with Social Equity* (LC/G.1702(SES.24/4)), Santiago, Chile, 1992.

⁸ Document in progress.

SUMMARY

1. Introduction

Experience shows that economic growth does not necessarily or automatically lead to social equity. ECLAC has argued, however, that environmentally sustainable growth with equity, in a democracy, is not only desirable but possible.¹ Indeed, just as social equity cannot be attained in the absence of strong, sustained growth, such growth likewise calls for a reasonable degree of social and political stability, and this in turn means meeting certain minimum requisites of equity. It is clear from this interdependence between growth and equity that it is necessary to advance towards these two objectives *simultaneously rather than sequentially*, and this represents an unprecedented challenge.

For the purposes of this document, it is understood that equity will improve through advances in the attainment of at least one of the following three objectives. The first of these is to minimize the proportion of persons and households whose living conditions are below those which society considers acceptable, not only economically but also socially and politically. The second is to promote the development of the latent skills existing in all groups of society, progressively doing away with legally established privileges and forms of discrimination, as well as any other forms of inequality of opportunity, including those associated with social, ethnic or geographical origin or gender. The third is to do everything possible to ensure that neither power, wealth, nor the fruits of progress are concentrated in such a manner as to restrict the freedom of present or future generations, harming the

environment in which they must live and develop.

Governments and societies have made many efforts to correct the inequalities which exist in the nations of Latin America and the Caribbean by placing ever-greater emphasis on social policies. At the same time, various international agencies have focused their efforts on the formulation of proposals for combating poverty and emphasizing the social aspects of development. The ECLAC secretariat, however, has preferred to tackle these issues through an approach which integrates the economic and social dimensions and seeks to bring out the areas of complementarity between growth and equity.

2. A single task: the integrated approach

There are various approaches to the best way of seeking out the areas of complementarity between growth and equity. One view, taking a monistic approach, contends that there is incompatibility between the two, but that time will resolve it. What is needed is growth; once growth is achieved, its fruits will soon benefit the majority of the population. There is extensive experience in the region, however, which casts doubt on the validity of this "trickle-down" approach. Another maintains that the best way of reconciling the objectives of growth and equity is to address them separately, with economic policy aiming at securing a satisfactory level of growth, while social policy concentrates on the problem of distribution. This dichotomy, which is attractive because of its operational simplicity, assumes that the economic policy will

be distributively neutral and that its regressive tendencies, if any, will be manageable, so that the social policy can make up for or correct any shortcomings with regard to equity. There is every reason to assume, however, that the economic policy mix allows for extensive combinations, some of which may have wide-ranging regressive effects on distribution (if they give rise to high levels of unemployment or underemployment, for example) which often outstrip the progressive distributive effects of social policy. Consequently, it is not possible to pursue growth with equity unless both are objectives of both economic and social policy. This is the integrated approach which is adopted in the present document. It involves, on the one hand, choosing economic policies which favour not only growth but also social equity and, on the other hand, emphasizing in social policy not only equity but also the effects of this policy in terms of productivity and efficiency.

Even if growth and social equity were always at odds, so that progress could not be made towards one except at the expense of the other, it would still make sense to give a distributive bias to economic policy in order to avoid even greater regressive impacts. There is indeed a tendency to emphasize the trade-offs between the two objectives rather than the areas in which they can complement each other, and this causes many opportunities for action to be overlooked. This is particularly regrettable when the area of complementarity is equal to or greater than that of the trade-offs, which is especially the case when growth is based on the spread or absorption of technical progress.

The central aim of this proposal is thus to outline policies which take advantage of and strengthen the areas of complementarity and reduce those of trade-offs, so as to permit the objectives of growth and social equity to be addressed simultaneously, rather than sequentially, as a single, integrated task. Thus, of the three major types of policies which promote social equity—those aimed at increasing productive employment, investment in human capital and transfers—only in the latter could advances be made at the expense of

growth. In contrast, while in the worst of cases investment in human capital could, because of its long lead time, involve sacrificing a modicum of present growth in order to secure greater growth in the future, in the long run such investment furthers competitiveness and equity. Finally, as the creation of productive employment is perhaps the strongest and best indication that growth and social equity are being achieved in a simultaneous and complementary manner, priority should be given to policies that stimulate the creation of such jobs, especially in combination with a rising level of productivity. It must be borne in mind, in this respect, that until such time as access to productive employment is open to all, there can be no question of even minimal levels of equality of opportunity.

3. Central elements of the integrated approach

a) *Technical progress*

A central element in the ECLAC proposal is the changing of production patterns based on the deliberate and systematic absorption of technical progress in order to attain increasingly higher and sustainable levels of productivity and to create a greater number of productive jobs. In order to bring about these changes, improvements are needed in entrepreneurial capacity and, above all, in the education and training of the labour force.

Enhancing competitiveness and improving the countries' position in the international economy are tasks that call for a better organization of production and marketing on the part of enterprises, be they leading corporations or microenterprises. Small and medium-sized firms are particularly important in this context, since they employ the bulk of the labour force and account for a good proportion of regional output.

The absorption and dissemination of technical progress calls for a suitable

technological infrastructure, better production linkages from the natural resource base on up, and the modernization of basic production support services such as transport, communications, ports and trade. The proposal is thus systemic in nature, since it sees the enterprise as part of an extensive set of linkages, all of which help to further international competitiveness.

Although technological modernization will necessarily include some elements of innovation, the fact that the region is a relative newcomer to industrialization and is at an intermediate stage of development means that the adaptation and absorption of existing technology is even more important. Consequently, the policies to be chosen should stimulate the rapid and wide-ranging spread of technological progress, which has less concentrative effects than providing incentives for innovation and may well turn out to be more equitable. This factor can contribute to a process of convergence and complementarity between the aims of growth and social equity in Latin America and the Caribbean.

This process of technological modernization is not automatic, however. In fact, the economic history of the region since the Second World War shows that far from leapfrogging ahead, productivity has been rising at an ever-slower rate, a gradual erosion of the urban and industrial infrastructure has taken place, which in turn has had serious effects on employment and the quality of life of the most underprivileged groups, while technological progress has been more and more sluggish. Furthermore, economic growth has become increasingly costly: it has required ever greater investment and created fewer and fewer jobs. This is why it is so important to reverse this trend by changing existing production patterns.

b) *Productive employment*

A second salient element of the integrated approach is the attainment of full productive employment, since this is the main means

whereby the majority of the population can contribute to development and share in its fruits. As the wage bill (the product of the number of workers and the wages paid) depends above all on increases in total productivity, which in turn depends on technological modernization, only dynamic changes in production patterns can give rise to strong and sustained growth of both productive employment and total wages.

The idea that any significant form of growth could be led by the informal sector must therefore be discarded as a chimera. This is not to deny its important role not only as a refuge for unemployed labour in times of recession but also as an expression of and channel for latent entrepreneurial talent. Except in a very few lines of activity where the informal sector displays notable dynamism, however, its wage bill is a direct function of the growth in formal activity. If the formal sector does not grow, then total informal-sector wages will not grow either. If informal employment did grow in these circumstances, it would be a "spurious" expansion, such as occurred in the 1980s. The truth, it would appear, is that in those years there was no increase in the demand for labour, but on the contrary an *insufficiency* of such demand: in other words, the growth in informal-sector employment was not due to the creation of new jobs but above all to the sharing out of the existing jobs among a larger number of persons. Non-spurious growth and modernization of the informal sector will accompany changes in production patterns, but they cannot lead them.

Of course, if a higher level of output per worker unequivocally meant greater efficiency and productivity, there could be a conflict between productivity and employment, since the enterprises and activities generating more employment per unit of output would necessarily be those with lower productivity. However, this apparent conflict between productivity and employment actually stems from one-sided concepts of efficiency and productivity. Thus, economic efficiency refers to the use made of all the factors of production, not just labour. As technological change usually gives rise to

savings not only of labour but also of capital, a technology which generates a higher level of employment per unit of output and which may therefore seem to be less productive, may in economic terms be the most useful and have the highest overall productivity if it leads to a sufficient saving of capital, thereby doing away with the apparent conflict between productivity and employment.²

c) *Investment in human resources*

A third cornerstone of the integrated approach concerns action to facilitate the accumulation of human capital (training, education, nutrition of children and expectant mothers, and health, including drinking water and sanitation infrastructure). This type of action, and especially investment in education, clearly illustrates the complementarity between measures aimed at achieving growth objectives, on the one hand, and social equity, on the other. Indeed, in the present document special emphasis is placed on the promotion of education and knowledge, not only as a basic social service, but also as one of the pillars of technical progress. This is why, in order to reconcile efficiency with equity, it is essential to *improve the quality* of education and ensure that all social strata have equal access to it.

In order to achieve this, it is essential to increase decentralization and local autonomy, although the central bodies should be given responsibility for strategic planning functions and for ensuring minimum acceptable quality standards, together with the supplementary distributive allocations that this involves. Greater internal incentives are needed in order to induce prompter and better attention to the public's needs, as well as greater efficiency in the use of resources. In order for significant educational reform to be possible, a major, permanent financial commitment by society is needed.

4. Two basic features of the ECLAC proposal

As in the case of *Changing Production Patterns with Social Equity*, the proposal put forward in this document has two basic features. The first of these is that the elimination of distortions and the establishment of "correct" prices are not of themselves enough to ensure growth with equity. Instead, the deliberate and systematic incorporation of technical progress into the production process requires not only correct prices but also selective intervention, sectoral policies and institutional changes in the economic and social network within which enterprises operate. The second characteristic is that the specific proposals must differ in line with the initial conditions of the region and of each of its countries.

a) *Institutional changes*

With regard to institutional changes, the present document delves most deeply into three mechanisms which are often neglected in other approaches but which are in fact essential in order to make simultaneous and sustainable progress in the areas of growth and equity. First, the effective functioning of the market not only involves market-based prices and deregulation (that is to say, passive action) but also often calls for *active* intervention in order to create or stimulate markets which do not yet exist or are insufficient or segmented. There are serious shortcomings in the capital markets, for example, especially in terms of investments in human capital and long-term financing, not only for medium-sized and small enterprises but also for microenterprises. These problems will be analysed later.

Secondly, because markets are interrelated, intervention is really required in the market where the shortcoming originated, rather than in the market where the fault finally manifested itself. This is so in the case of unemployment and underemployment, for example: from a long-term perspective, the origin of these faults

is not so much in the labour market as in the capital market (relative scarcity, poor mobility, segmentation). In the short term, on the other hand, the rise in unemployment and underemployment during stabilization processes is due not so much to the stickiness of wages as to other shortcomings such as inflated and insufficiently flexible prices in the market for goods, because producers expect a higher rate of inflation than that projected in the current economic policy.

Thirdly, in addition to improving the market it is necessary to make structural and institutional changes. Examples of this are measures to modernize labour relations and promote worker participation in improving the results of the enterprise, or the emphasis on the need to take measures to increase saving, not so much by raising interest rates as through social insurance or loans for investments in education, housing and access to agricultural land.

b) *The special features of the region and of each country*

Even if there were no differences at all between the general approaches for promoting growth with social equity, specific proposals must necessarily vary in line with the initial conditions prevailing in the Latin American and Caribbean region, which distinguish it from other regions of the world, and the different conditions of the individual countries.

It may be recalled in this respect that a great many of the Latin American nations, whose economies are at an intermediate stage of development, have a solid existing industrial base and their inhabitants mostly live in urban areas. At least in the case of countries where industrialization has already made important inroads, this raises the question of how best to use this industrial base and how to orient it towards exports.

Likewise, in view of the fact that in the post-war period there has been an extraordinary expansion in education—in many countries primary education is virtually universal, and

secondary and university-level enrollment has also risen significantly—the comparative advantages of the region must increasingly be sought in production activities which make intensive use of skilled or semi-skilled rather than unskilled labour. This suggests that the central aim of educational policy should increasingly be to improve the *quality* rather than the mere quantity of education.

Finally, the region is relatively well endowed with natural resources, especially non-renewable resources. These represent a rich heritage through which to promote international competitiveness based on the incorporation of technical progress within a process of growing production linkages, provided that this does not inhibit the development of other exports.³

5. Main aspects of policies to promote the integrated approach

None of the aspects considered to be of central importance in the integrated approach—technical progress, the creation of productive employment and investment in human resources—are objectives specifically associated with a single policy but must to some extent form part of virtually all policies, whether economic or social. The main policy areas to be considered include technical progress, modalities of integration into the international economy, the saving and investment process, the labour markets, social policy and participation.

a) *Technical progress and interaction with the international economy*

The improvement of the region's position in the international economy through increasingly complex and dynamic exports is the counterpart of changing production patterns with social equity.⁴ This appears to be the most promising way of securing rapid and sustained growth in productive employment and the wage bill and thereby contributing to both growth and equity. This is so in the short term, because the

current shortage of foreign exchange means that expansion of output and employment is closely dependent on the generation or saving of such funds. Likewise, although until recently incentives in the region were strongly biased towards production for the protected domestic market, it is reasonable to assume that it will be easier and more advantageous to generate additional foreign exchange by expanding exports rather than making further attempts at import substitution.

In the long term, an internationally competitive orientation likewise promises to be more efficient and equitable, since the potential additional exports are usually more labour-intensive than whatever import substitution may still be attempted. In particular, it may be expected that the new exports will incorporate ever greater value added, especially of skilled and semi-skilled labour.

Since the aim is to gain international competitiveness, especially through the promotion of exports, a much broader range of policies than mere tariff reduction will be required,⁵ for experience suggests that international competitiveness is based just as much on systemic efficiency as on the nature of the countries' participation in the most dynamic markets. In order to achieve and maintain such competitiveness, suitable economic and sectoral policies are naturally required. However, this result also depends on human resources (especially the vigour and breadth of vision of the entrepreneurial base); on the absorption and spread of technical progress, two of whose most important expressions are informatics and telecommunications; and finally, the scientific and technological system and its linkages with the system of production.

A coherent and sustained macroeconomic policy, including a high and stable exchange rate, together with the rationalization and reduction of tariffs and the replacement of non-tariff barriers with tariffs, would appear to be a necessary but insufficient condition for progressing in the field of international competitiveness. Consideration will also need to be given, among other measures, to the

introduction of subsidies to cover research and development costs in selected export lines considered to be promising and dynamic; the establishment of special incentives to back up "pioneering" exports (and, to a lesser extent, to support the other non-traditional exports) or to penetrate new markets; the reduction of excessive loading and unloading costs in ports; the broadening of the export base of the country's medium-sized and small enterprises; and promotion of the internationalization of leading firms through investments abroad.

b) *The saving and investment process*

The rapid creation of productive jobs, and hence the possibility of growth with social equity, are closely dependent on the level of investment. In order for this growth and the employment thus generated to be sustainable in time, it is also necessary to invest in the recovery and conservation of natural capital, which is currently suffering excessively rapid depreciation. This is why a bigger public and private austerity effort is essential, both to raise investment and to move towards greater equity. Increased saving, especially by wage-earners, is doubly favourable for this objective, since it makes it possible to create productive jobs and stimulates the accumulation of capital by the workers themselves. Some potential mechanisms for this purpose are institutionalized investment-savings schemes (supplementary to or independent of the social security system) and other mechanisms which encourage saving to become eligible for programmes to provide housing, access to land, or education.

Likewise, even if social security is not reorganized on the basis of individual capitalization, it is possible to increase public saving by reducing the deficit of many social security systems by taking steps to eliminate special privileges, to adapt benefits to a working life which is now a good deal longer than in the past, and ensuring that the benefits are in line with the actuarial value of

the respective welfare fund and not its cash flow.

In order to speed up the creation of productive employment, it is necessary not only to increase saving, but also to improve the allocation of the corresponding capital, since the shortage of productive jobs (or the presence of underemployment) is usually due not only to shortcomings in the labour market but also to faults in the physical capital and land markets. Thus, the region's employment problem is due not only to the relative shortage of capital—which is an inevitable feature of any developing country—but also to a shortage of employment aggravated by the limited mobility of capital between firms and sectors, as is shown by the high degree of self-financing that is a characteristic of all enterprises except the largest ones. This insufficient mobility of capital, together with the concentration of capital and land in just a few hands, is one of the reasons why some enterprises and activities are excessively or prematurely capital-intensive.

It is necessary to overcome the most serious shortcomings in the capital market in order to increase efficiency and employment and, ultimately, improve income distribution. Prominent among these shortcomings is the fact that there is no long-term capital market for the bulk of the firms in the region (those whose shares are not traded on the Stock Exchange), nor is there any market for investment in human capital. Likewise, there is a lack of mechanisms to provide or take the place of guarantees for a large number of small enterprises, nor are there channels for the distribution of credit to which the bulk of agricultural enterprises or small or medium-sized firms in the other sectors of production can gain access.

The land market suffers from serious shortcomings, and access to it is very inequitable: a significant proportion of the land is not covered by legal title deeds; in a number of countries, ownership is still highly concentrated, and, moreover, the appraised value for tax purposes is low and erratic, while there is no suitable machinery for raising the appraisal value with the passage of time or

because of improvements in public infrastructure; nor has there been full development of the potential for leasing, especially in respect of the purchase of used equipment (non-polluting), which is often very suitable for small firms in all sectors.

c) *Labour markets: participation and consensus-building*

In order to create productive jobs, substantial changes must be made in labour relations. The market trends towards more differentiated products of higher quality require the gradual replacement of enterprises having a vertical, hierarchical structure by others with more horizontal and flexible systems characterized by intensive feedback, in order to make fuller use of the initiative, creativity and responsibility of the labour force. Modernizing labour relations in this way means that, on the one hand, the enterprise treats its workers as valued partners rather than as mere factors of production. On the other hand, it calls for a technified trade union movement which is aware that its "opponent" is not so much the entrepreneur as other competing firms, and that its objectives must therefore also include the raising of productivity.

There are various means of participation which point in the right direction. Among these, one which could promote cooperation instead of confrontation is the system of "participative wages". This system not only stimulates improved productivity by paying part of the wages on a variable basis (as a function of profits, sales, or some similar arrangement) but, even more importantly, tends to stabilize or even increase employment. It would therefore be well worth exploring this form of remuneration, which —although it is

just beginning to be applied in the region—has begun to attract growing interest.

d) *Social policy: investment in human resources and transfers*

The lack of resources in the 1980s had a serious effect on social expenditure, and it is therefore essential to recover past levels of funding in order to be able to make beneficial investments in human resources and carry out minimum transfer programmes. Until those levels of spending are recovered, however, it will be all the more urgent to set clear priorities between the various social programmes and within each of them. Except in the case of urgent relief measures for situations where the survival of human beings is at stake or there is an imminent danger of irreversible deterioration of certain basic indicators of well-being, this means giving preference to social policies which are *functional* to development, at least in the early years of the process of restructuring and growth.

Particularly important in this respect are social investment programmes aimed at halting the transmission of poverty from one generation to another. The highest fertility rates are found precisely in the poorest families; likewise, mothers of poor families run the biggest risk of having difficult pregnancies; their children suffer from the worst nutritional deficiencies, and they have the biggest problems of learning in school and register the highest rates of repeating school years and dropping out of school altogether. Later, they have the greatest likelihood of ending up in dead-end, low-productivity jobs in the informal sector, thus completing the vicious circle of poverty, which is transmitted in this way from one generation to another.

In order to break this vicious circle, the measures taken must concentrate on those links in the chain which reproduce poverty conditions from one generation to another. In addition to measures in the field of education, which were already referred to in previous sections, such action must seek to: i) create conditions which

favour responsible parenthood, so that families can bring their fertility closer to a rate they desire, as far as possible; ii) promote the establishment of mother and child care programmes which will ensure that low-income women have access to regular examinations and care during their pregnancy, followed by similar attention for mother and baby, supplemented with free milk programmes; iii) expand pre-school education (including supplementary food programmes), especially in low-income sectors, and iv) expand training programmes so that every worker will have access to them not just once but several times during his working life.

Finally, with regard to longer-term transfer-based social policies —especially those carried out through the social security system— their coverage should be expanded both in terms of the type of benefits provided and the incorporation into them—at least as far as basic benefits are concerned— of groups of needy persons not covered by the system. This is necessary because the present social security system is marked by very serious shortcomings from the point of view of social equity, which are reflected in the insufficient coverage provided by the system and wide differences in benefits, adversely affecting in both cases the welfare of the poorest and most marginal social groups.

Likewise, priority should be given, as far as possible, to transfers which increase *household* income rather than that of individuals, centring this attention on allowances for the lowest-income heads of households. This approach concentrates the benefits on the poorest families, tends to further formal employment for the lowest-income heads of households, and raises income in a more socially acceptable way, since the household income is supplemented when the head of household is working, in contrast with other types of income supplements or subsidies which are only given if the head of household is unemployed.

e) ***Participation, changing production patterns and social equity***

The present trend towards the consolidation of democracy in the region would be further strengthened by growth with social equity, but the erosion of equity would frustrate and weaken it, giving rise to social and political instability. Attaining a state of equilibrium in this respect means eschewing both the temptation to resort to technocracy (which does not take account of social demands) and the lure of populist solutions (which place voluntarism above technical considerations). The most appropriate course is that based on the mobilization of the most inherently legitimate instruments of democracy: participation and consensus-building.⁶

For this purpose, it is necessary —among other things— to organize the beneficiary groups, since they are usually not only on the sidelines of the sources of economic power but also marginalized from social and political power. Indeed, the evolution of social policies in the history of the developed countries has gone hand in hand with the democratic organization of society. The difficulty in the present circumstances, however, is that it is not just a question of empowering those who have hitherto been excluded, in order to make the programme politically viable, but also of ensuring that they participate in a responsible manner, since it will obviously not be possible to fully satisfy their overdue demands in the short term.

Clearly, no programme for changing production patterns with equity can give good results without extensive consensus-building, and the overdue social demands can be kept under control only through a programme which assures broad participation by the people at large in the results. For this purpose, it would be a good idea to place greater emphasis on, *inter alia*, decentralization and municipalization.

6. Factors conditioning the integrated approach

Finally, it is clear that there are many factors which condition the capacity of governments and societies to advance towards changing production patterns with social equity and above all to seek growth based at once on greater international competitiveness and greater equity. Three of these factors are explored in this document, and some proposals are put forward for minimizing their conditioning effect.

a) ***The international scenario***

The profound changes which are taking place in the international environment, and their impacts on the countries of Latin America and the Caribbean, will be determining elements for the success of changing production patterns with social equity. Both the astounding geopolitical changes and the recent globalization of the economy introduce an element of uncertainty with regard to the external environment which will call for an ever-greater capacity for adaptation on the part of the countries of the region. At any rate, these changes have momentous implications which call for both individual and collective responses from the countries of Latin America and the Caribbean, as well as a reconciliation of views in the field of international cooperation.

In view of the globalization of the international economy, there is an even greater need for multilateral rules, and to ensure that, in the liberalization of world trade, bilateral or regional integration agreements become the building blocks of a transparent and non-discriminatory economic system, rather than stumbling-blocks to its progress. In the financial field —particularly in view of the growing demand for financial resources all over the world— it is essential to continue the efforts to increase domestic saving, as well as to strengthen the process of reduction of the external debt and to

introduce new financial mechanisms to forestall possible problems stemming from an excessive multilateral debt burden. All this could be supplemented with the diversification and monitoring of those financial instruments which are enabling some countries of the region to gain renewed access to the international private capital market.

b) *Stabilization*

The recovery and subsequent maintenance of basic macroeconomic equilibria is a necessary requisite for any process of changing production patterns with equity. Severe imbalances make sustained growth impossible and have a harmful distributive impact on the poorest groups. The less recessionary an anti-inflation programme is, the less severe its impact on employment, and hence on income distribution. This means, as in other cases, that efficiency in production and social equity are basically *complementary factors* in the stabilization phase. At all events, in view of the critical nature of the situation in that phase, it is often impossible to do much more than lessen the damage suffered by the neediest groups, by taking steps to ensure the maintenance of at least a minimally acceptable level of subsistence.

Experience indicates that the smaller the outward resource transfer is, or the longer it can be spread out over time, the lower the economic and social cost of this type of adjustment. This is not enough, however, for without strict fiscal control and correction of key relative prices, every stabilization programme will run the risk of failure. At the same time, the danger of a deep recession will be still greater unless steps are taken to guide the inflationary expectations of economic agents. This is why it is so important that such a programme should be accompanied by a price and income policy—if possible reached by consensus—which brings prices as quickly as possible close to their equilibrium values: that is to say, values compatible with the target figure for inflation implicit in monetary and fiscal policy.

Experience also indicates that the greatest recessionary and distributive effects are related to reductions in expenditure (a decline in investment but not in current spending, or the elimination of general indirect subsidies without offsetting this through selective direct subsidies). Hence, an adjustment which allows for fiscal equilibrium while at the same time increasing fiscal revenue rather than reducing public expenditure it will naturally tend to be less recessionary in its effects.

c) *Restructuring the State*

Progress can be made towards changing production patterns with equity only by substantially restructuring the State. This means, on the one hand, that governments must give up many functions where their action is not considered essential, especially in the field of production, while on the other hand they must devote themselves even more vigorously to certain key functions such as macroeconomic management, social and distributive investment, promoting the improvement of the country's position in the international economy the absorption of technical progress into the production process, and defence of the environment.⁷

None of these tasks will succeed unless public sector finances are strengthened and consolidated by ensuring a reasonable amount of revenue and a sound tax structure. Indeed, perhaps the most telling index of the true weakness of the State is the difference between its enormous capacity for spending and its severely limited capacity for collecting revenue.

In this respect, fiscal policy is a fundamental link between economic and social policies aimed at making progress simultaneously towards growth based on rising productivity and towards greater social equity. On the one hand, unless it is possible to reduce the fiscal deficit and keep the macroeconomic imbalances within acceptable limits, achieving sustained changes in production patterns will not be possible. Indeed, in order to increase national

saving and hence growth and productive employment, it is vitally important to consolidate the fiscal balance on more solid and lasting foundations. On the other hand, a substantial part of the potential achievements of the desirable social policies —both in investment in human capital (education, training, health and nutrition) and in social security and transfers— will depend on the collection of sufficient resources to cover these needs.

This is why it is proposed to attain fiscal balance on the basis of a reasonable level of revenue rather than through mere reductions of expenditure. Expenditure has in fact been significantly cut in most of the countries in all areas, with two important exceptions: public external debt service and, very often, military spending. This fact, together with the low taxes prevailing in most of the countries of the region, means that it is necessary to recover levels of tax revenue at least equal to those obtained before the crisis, and in many cases they should even be increased, since in most of the countries of the region there is ample room to raise them without losing competitiveness. The scope for such increases is particularly great, of course, in those countries where the tax burden does not exceed 10% of GDP. Moreover, the tax system is perfectly capable of contributing to the redistribution of resources, not only through the structure of expenditure but also through revenue collection, which of course means a broader tax base, with less evasion, and a more progressive tax structure.

7. A feasible task

The task of simultaneously achieving a change in production patterns, accompanied by social equity, in a context of environmental sustainability is much more complex than the pursuit of only one of these objectives, sacrificing or neglecting the others. Modern societies increasingly see them as an indivisible group, however, so that a lag in any one of the three would mean lower standards of well-being. This same social

appraisal means that a process which ignores any of the objectives simply cannot be sustained, for such processes lead to social tensions, violence, and the ultimate reversal of such little progress as might have been made in relation to any of the objectives.

Consequently, it becomes a matter of the highest priority to explore policies capable of leading to the simultaneous achievement of the above-mentioned social objectives within a context of freedom. This document puts forward an integrated approach based on the realities of the region and other recent ECLAC studies. In addition, it proposes certain strategic policy lines, with emphasis on those that tend to strengthen changing production patterns with equity in a sustainable manner.

The conclusions of this exploration are hopeful: the gradual attainment of the proposed objectives appears to be feasible. There are policies for achieving them; there is a conceptual framework against which to set the specific actions and their results, and the crisis of the 1980s, despite all its negative effects, served as a stimulus for the taking of some difficult steps which allow for the growing consolidation of the economic, social and institutional bases for future progress.

Notes

¹ See, for example, ECLAC, *Changing Production Patterns with Social Equity*, op.cit., and *Sustainable Development: Changing Production Patterns, Social Equity and the Environment*, op.cit.

² On the other hand, there may be distributive problems if the new technology makes it possible to save more labour than capital. As in this case the market itself will tend to reduce wages, it will be necessary to apply compensatory policies —financed by the increase in output generated by technological change— in order to offset the possible regressive effects that could result.

³ ECLAC, *Changing Production Patterns with Social Equity*, op. cit., pp. 90-94.

⁴ Ibid., passim.

⁵ Ibid., pp. 97-156.

⁶ Ibid., pp. 54-59.

⁷ Ibid., passim.

Chapter I

EROSION OF SOCIAL EQUITY

The secretariat's reasons for stressing the importance of changing production patterns with greater equity have been fully documented in earlier proposals,¹ and will not be repeated here. Mention will be made of only a few additional indicators of how the considerable economic and social backwardness of broad sectors of the population tended to worsen in the 1980s. The document *Changing Production Patterns with Social Equity* points out that no country in Latin America or the Caribbean has managed to combine dynamic insertion in the international economy with acceptable levels of social equity.² During the past biennium, the secretariat has made some progress in clarifying the scope of this phenomenon.³

1. *The post-war period*

In Latin American and Caribbean societies in the early 1980s, a sharp contrast existed —although to varying degrees depending on the country— between the living conditions of the modernized strata and those of marginalized groups, whose members were excluded from many modern benefits. During the post-war period, three and a half decades of economic and social change had enabled vast sectors to become active participants in political and social life —through access to education, culture, health and adequate housing— and to adopt patterns of mass consumption. The sectors at the extreme opposite pole, representing 40% or more of the population, consisted of urban and rural masses

living in poverty, although their absolute levels of education, health and income were higher than they had been 30 years before. This combination of dynamic progress and inequality in Latin America and the Caribbean stood in contrast to the experience of a number of more recently industrializing countries; these countries, in other regions but within the same international context, were able to compatibilize growth with social equity.

Despite their economic expansion, the region's economies were already showing signs of exhaustion before the crisis of the 1980s. Investments aimed at meeting the demand of diffuse domestic markets, which were characterized by a marked concentration of income, tended to lose steam. The same trend occurred in commodity exports, which were affected by the loss of their relative importance in international markets, and by declining prices, protectionism and the export of surpluses by the industrialized countries.

Moreover, despite the building of an industrial base and the formation of a pool of skilled human resources, serious obstacles arose with the launching of a broad, intensive effort to encourage industrial exports, based on the absorption of technical progress in the exploitation of natural resources, including land, or on the technification of the available labour supply. Even where export subsidies existed, there was normally a bias against this activity and an absence of stimuli to competition. This

difficulty was offset in one of two ways. One was to sacrifice part of the revenue derived from the natural resources in question, since the costs of exploitation were so low that the export of these resources would continue to be profitable despite the inefficiencies involved and the trend in the other direction. The other way was to pay extremely low wages.

The above-mentioned development pattern in turn strengthened the concentration of local demand. Part of this demand was generated by revenue from the non-sustainable exploitation of natural resources. Another part stemmed from the fact that the industrial sector, whose growing capital-output ratio, associated with an import substitution strategy which was being maintained at a higher-than-desirable level, reinforced the concentration of income by severely limiting job creation. At the same time, this industrial development failed to take into account the management of the increasing waste being produced (whether in gaseous, liquid or solid form), leading to more and more severe pollution.

The expansion of services, especially social services, and direct government action tended to mitigate, to a greater or lesser extent, depending on the country, the destabilizing effects of the above-mentioned process. However, neither social policy nor direct State intervention was enough to correct the imbalances stemming from a development model that was soon to become unsustainable. By the end of the 1970s, the region's external indebtedness made it possible to prolong a process that was already showing clear signs of exhaustion: inevitably, the recession would combine with existing inequalities, and both would then become basic characteristics of the economic crises of the Latin American and Caribbean economies.

2. The 1980s

Problems involving distribution worsened in the 1980s. The balance-of-payments crisis of 1981-1982 was rapidly transferred to public and

private finances, and from there, by various ways and means, to the rest of society.

It would be difficult to exaggerate the scope of the adjustments the countries had to make in the early 1980s. To differing degrees in each country, positive external flows became negative: the countries of the region, after having received financial resources equivalent to nearly 2% of GDP in 1978-1980, began to transfer resources abroad representing a total of almost 4% of GDP during the period 1983-1985. The practical counterpart of this turnaround was that the trade deficit turned into a surplus, largely as a result of the contraction of the domestic economy and of imports. The scope of this phenomenon can best be appreciated by comparing it, for example, to the long negotiations that usually precede tax reforms intended to transfer 1% or 2% of GDP.

These changes had multiple economic and social effects. In the great majority of countries, inflation soared, disproportionately affecting the poorest sectors. The difficulties experienced by both public and private finances deeply affected the investment process, which was no longer able to stimulate the changes in production patterns which would have made these patterns more compatible with the new international environment. The steps taken to deal with the crisis soon went beyond macroeconomics, modifying the public sector's role and existing arrangements to facilitate the international insertion of the economy. These internal and external imbalances, together with economic and social policy reactions to them, had a significant impact, on the one hand, on the environment—mainly in the form of the overexploitation of natural resources and the disproportionate increase in air and water pollution, caused by the concentration of industrialization in the big cities, which had grave effects on public health—and, on the other hand, on social equity, in terms of employment, income distribution, poverty, social services and the natural heritage, all of which are discussed below.

a) *Population*

The rate of population growth in the region as a whole fell from 2.4% annually in the 1970s to 2.1% in the 1980s, mitigating the effects of the crisis to some extent. The heterogeneity of the demographic transition process in the region was reflected in significant differences among countries (see table I-1), but most of them registered moderate fertility and moderate or low mortality rates. Brazil, Colombia, Costa Rica, Dominican Republic, Guyana, Ecuador, Mexico, Panama, Peru, Suriname, Trinidad and Tobago and Venezuela showed a marked decline in the fertility rate in the past 25 years, from 6.5 to 3.5 children per woman of childbearing age. Life expectancy increased considerably, and the use of contraceptive measures became more widespread in these countries. On the other hand, in Argentina, Chile, Cuba, Guadeloupe, Jamaica, Martinique, Puerto Rico and Uruguay, fertility and mortality rates were low, with an average natural growth of about 1.2%. Especially noteworthy were the cases of Cuba and a number of Caribbean countries, whose total fertility rates were lower than the population replacement rate.

Bolivia and Haiti stood at the other end of the scale. At the beginning of the 1990s they had high fertility and mortality levels, with a total fertility of more than 4.5 children per woman. El Salvador, Guatemala, Honduras, Nicaragua and Paraguay, whose high fertility indexes were accompanied by moderate mortality rates, and whose population in some cases had more knowledge about modern contraceptive methods, showed total fertility rates which were similar to or greater than those of the first group.

Thus, in general, the poorest countries register the highest population growth rates. In turn, fertility levels in the poor sectors of the countries of the region are higher than those of the other sectors, a phenomenon which occurs both in countries with large poor populations and in those with smaller proportions living in poverty (see box I-1). Given the correlation

between level of education and income, it is also important to note that, in countries such as Brazil, Colombia and Mexico, there is evidence of a higher fertility rate among mothers who had no schooling or who did not complete primary school.

In addition to this relationship between fertility and income, there was a clear manifestation during the 1980s of two common features in regional demographic trends: the gradual ageing of the population and the process of urbanization. Thus, in all countries the growth rate of the groups age 15 or older was greater than that of the population under age 15. The demographic transition process in the region was also reflected in a gradual increase in the proportion of the population over age 60, which rose to approximately 13% in the countries with lowest fertility rates, in contrast to between 5% and 7% in the other countries. The greater relative weight of the ageing population resulted in higher social expenditure in the form of pensions, and this added burden was a contributing factor in the difficulties faced by social services in such countries as Argentina, Chile, Uruguay and Cuba in the 1980s.

In turn, the urban population, which represented 65% of the total Latin American population in 1980 rose to 71% in 1990, while in the Caribbean it increased from 53% to 60% in the same period. The urbanization process, combined with the greater impact of the crisis on urban areas and with the higher fertility rate of poor households, led to a considerable increase in the number of poor people living in cities and a rise in the ratio of the urban poor to the total population living in poverty. Moreover, in view of the higher fertility rate in the total poor population, the incidence of poverty tended to be higher among children and young adults. The result of all the above, together with the existing mechanisms for the transmission of poverty patterns from generation to generation, —such as the use of child labour, which involves sacrificing education, or teenage pregnancy, where illegitimacy is common— was that certain conditions conducive to greater social inequality were exacerbated in the 1980s.

Table 1-1

LATIN AMERICA: POPULATION GROWTH RATES

	Total fertility		Population by age			Total population	
	1980-1985	1990-1995	1970-1980		1970-1980 1980-1990		
			15 years or older	less than 15 years	15 years or older	less than 15 years	
LATIN AMERICA							
Argentina	3.94	3.25	1.7	2.9	1.3	2.7	
Bolivia	3.15	2.79	1.9	1.5	1.3	1.4	
Brazil	5.50	4.56	2.6	2.5	2.1	2.8	
Colombia	3.81	3.16	1.2	3.1	1.5	2.5	
Costa Rica	3.51	2.92	1.1	3.2	0.8	2.8	
Cuba	3.50	3.02	1.1	4.0	2.1	3.2	
Chile	1.85	1.87	-0.3	2.1	-2.4	2.2	
Ecuador	2.80	2.66	0.0	2.5	0.8	2.1	
El Salvador	4.80	3.87	2.5	3.3	1.7	3.3	
Guatemala	5.21	4.51	2.2	2.4	1.1	1.8	
Haiti	6.12	5.36	2.8	2.8	2.8	2.9	
Honduras	5.17	4.79	1.6	1.7	1.8	2.0	
Mexico	6.16	4.94	3.4	3.3	2.8	3.9	
Nicaragua	4.29	3.16	2.4	3.3	0.8	3.4	
Panama	5.94	5.01	2.8	3.2	3.0	3.6	
Paraguay	3.46	2.87	1.9	3.4	0.7	3.0	
Peru	4.82	4.34	1.9	3.7	2.7	3.4	
Dominican Republic	4.65	3.57	2.2	3.1	1.2	2.9	
Uruguay	4.21	3.34	1.4	3.5	1.2	3.0	
Venezuela	2.57	2.33	0.0	0.5	0.2	0.8	
	4.10	3.47	2.4	4.3	2.0	3.2	
CARIBBEAN							
Barbados	3.19	2.85					
Guadeloupe	1.92	1.79	-1.8	1.5	-1.7	1.0	
Guyana	2.55	2.35	-2.8	2.1	-1.1	1.1	
Jamaica	3.26	2.40	-0.8	1.9	-1.5	1.7	
Martinique	3.55	2.38	-0.2	2.5	-0.5	2.5	
Puerto Rico	2.14	2.08	-3.7	2.0	-1.2	1.1	
Suriname	2.46	2.10	0.1	2.5	-1.1	1.6	
Trinidad and Tobago	3.39	2.56	-2.5	1.0	0.2	2.8	
	3.10	2.70	-1.0	2.3	1.6	1.7	

Source: Latin American Demographic Centre (CELADE).

Box I-1

POPULATION GROWTH AND POVERTY

On the basis of the household surveys used by ECLAC to prepare its estimates of poverty in Latin America in the 1980s, a projection was made of the effect of population growth on poverty indexes in Guatemala, a country noted for its high percentages of poor and indigent and now in the process of moderate demographic transition, and in Costa Rica, where the relative weight of the poor population is less, and which is undergoing a complete demographic transition.

According to tabulations from the surveys, population growth among the poor and indigent sectors is greater than that among the rest of the population. Nearly 60% of the poor are less than 20 years old, while in both the above countries this percentage stands at only 45% in the sectors having income above the poverty line. Differences also exist in the average size of households; in Guatemala, the average is six persons for indigent households and 5.4 for poor households, compared to 4.4 for the remaining population; in Costa Rica, the average size of poor and indigent households is five persons, compared to 4.4 for the rest.

In order to estimate the average annual natural growth of these populations and the corresponding number of births and deaths annually, fertility and mortality rates consistent with the information contained in studies conducted by CELADE were assigned to them. Thus, it was projected that in Guatemala the indigent would have the highest growth rate (3.4% annually), followed by the poor, with 2.5%, and by the rest of the population, with 2.3%. In Costa Rica the number of indigent and poor would grow at similar rates of around 2.5%, also above the 2.1% of the higher-income sectors.

On the basis of the assumption that these were the natural growth rates prevailing in the 1980s, it was estimated that in Guatemala 98% of the additional number of poor and indigent registered in Guatemala during the decade were attributable to natural population growth in these conditions, a percentage which reached only 55% in Costa Rica. This means that in the latter country other socio-economic factors besides demographic ones would explain the increase in poverty in Costa Rica. In the case of Guatemala, the additional number of persons below the poverty line during the decade appears to be a result of the high initial percentage of poor population combined with its growth, although the intervention of other socio-economic factors probably aggravated the situation of those who were already poor.

In past decades, the increased flow of international migrants has been one manifestation of economic, political and demographic imbalances in the region. From 1960 onward, Mexico became the principal source of migrants, mainly illegal workers; by the end of the 1980s, the number of Mexican workers who had emigrated to the United States had risen to about four million. In the same decade, however, the increase in migration from Central America, at first for political and social reasons and later for economic reasons, was twice that of migrant flows from Mexico. Thus, emigrants who have migrated to the United States now represent the equivalent of between 2% and 3% of the total population of Guatemala, between 5% and 6% of that of El Salvador and between 5% and 7% of that of Nicaragua. These figures, added to the number of internal migrants, refugees and emigrants to neighbouring countries, show that the total

number of uprooted people came to represent about 10% of the Central American population by the early 1990s.

Emigration from Caribbean countries to the United States and Canada has reached even greater proportions, although this has occurred over the past 30 years. During this period, migrants represented nearly 10% of the population of Cuba, the Dominican Republic and Haiti, while in the English-speaking Caribbean countries these figures rose to 14% in Trinidad and Tobago, 21% in Jamaica and 25% in Barbados. These data stand in contrast to those for the total historical emigration of Europeans, which amounted to about 12% of the continent's entire population during the last peak period, although this migration occurred over a span of almost 80 years (1846-1924).

Although emigration releases some of the pressure on the labour market, helps to raise the standard of living of the emigrants, brings in

foreign currency and strengthens economic ties between countries, it also entails a number of personal and social costs. The social costs include losses of investment in education, and less efficiency in the public and private sectors owing to brain-drain and higher family dependency rates. Emigration may call for additional government resources when the need to deal with sudden repatriations arises. There is also a risk of possible over-

investment in infrastructure in cases where emigrations significantly alter the estimated population growth rate or trends in population composition by age. Personal costs include the separation of families and problems of adaptation and discrimination faced by the immigrants in the new country. Despite these disadvantages, remittances from emigrants may provide considerable relief to poor households (see box I-2).

Box I-2

MIGRATIONS, REMITTANCES AND SAVING

In the period 1980-1989, remittances of foreign exchange from family members abroad doubled in Guatemala, quintupled in Nicaragua and increased tenfold in El Salvador. Since the main commodity exported by the three countries is coffee, it is significant that in Guatemala and Nicaragua the value of foreign exchange remittances rose to the equivalent of two thirds of the value of coffee exports, while in the case of El Salvador the amount was three times as much. For the three countries as a whole, total remittances rose from US\$192 million in 1980 to US\$1 067 million in 1989.

Because of the high cost of immigrating illegally into the United States (US\$1 000 - US\$2 000), poor families often save enough money to send one child abroad; this is the most frequent form of migration in these countries. Migration and remittances have thus become part of the family's survival strategy in the face of poverty.

In 1989, each family with members living abroad received an average of US\$800 in Nicaragua, US\$1 200 in El Salvador and US\$1 330 in Guatemala. Since the average income of all the beneficiary families is below the poverty line, these remittances make a decisive contribution to improving this situation. In Nicaragua, the value of the average remittance was equivalent to 34% of household income from work or other sources, while in El Salvador this percentage was 72%. In Guatemala, the estimated monthly remittance was even 15% higher than the average income of the beneficiary households from other sources, which barely covered the cost of the minimum basket of staple foods. However, the receipt of remittances does not necessarily offset the initial inequalities that exist in the heart of the poor sector itself. Thus, in the case of El Salvador and Nicaragua, the average remittance received by families in the relatively poorest socio-economic stratum was nearly 15% lower than that of the next highest stratum.

Studies on whether or not remittances serve as a source of investment leading to a stable income have shown that in most cases these contributions are used to meet basic needs, especially to buy food, and do not help to generate saving in any special way, although there appears to be a certain trend towards investment in home improvements, a fact which concurs with information on the use of these resources in other places.

Considerable attention has been given to the idea of using remittances as a source of saving and investment; this has led to a proposal for setting up funds in which resources derived from remittances would be supplemented by donations from abroad, under the supervision of external financial agencies. These funds could cover groups of countries. There is also the possibility of using future remittances as collateral for obtaining loans through flexible finance mechanisms, such as savings and loan cooperatives, or through a dynamic commercial banking system which could have access to these resources through national and international operations. Valuable data on the successes and failures of the implementation of this type of scheme in other regions is available. In Spain, for example, special accounts for remittances were opened which, after two years, enabled a person to take out a long-term loan (8-12 years) to buy a house, establish a small enterprise, buy shares of stock or pay for education or training. Although the exchange risk made it difficult to attract resources, the wide network of branch offices contributed to the relative success of the savings banks.

Source: Economic Commission for Latin America and the Caribbean (ECLAC), *Remesas y economía familiar en El Salvador, Guatemala and Nicaragua* (LC/MEX/L.154), Mexico City, June 1991.

b) *Employment and productivity*

Between the post-war period and the 1970s, labour moved from rural areas and the agricultural sector to urban industrial sectors and services, in other words from the least productive sector to other, more productive sectors. The sharp economic contraction suffered by the region in the 1980s, especially in the first half of the decade, is largely a reflection of the at times drastic reduction in the growth rate of industrial output and the dismantling and weakening of the public sector. As a result, the two job sources which had been traditionally associated with greater productivity, stability and social security collapsed.

Although the growth of the economically active population declined, as noted above, the regional process of demographic transition, which resulted in a predominance of young people, led to higher rates of increases in the economically active population than population growth rates as a whole. Thus, the annual growth rate of the population age 15 or older was 2.7% in the 1980s, after having reached 2.9% in the 1970s (see table I-1). National differences accounted for the fact that, in a number of countries, the economically active population actually increased to rates of around 3% or higher.

In any case, the expansion rate of the economically active population clearly surpassed the job-creation capacity of the region's still sluggish economies. The gap between the increase in the number of persons working or seeking work and the stagnation of production did not always manifest itself in open unemployment. It was also reflected, on the one hand, by a slowdown of rural-urban migration and an increase in agricultural jobs and, on the other hand, by a rise in the number of workers in the services sector. This last-mentioned sector, whose activity level remained practically the same, not only absorbed the traditional labour surpluses but did so in greater proportions. Besides preventing the sector from increasing the average product of labour, this

absorption cut the proportion significantly (see table I-2). Output per worker in the industrial sector also declined, while that of the agricultural sector rose moderately, although less than in previous decades. Labour absorption by the less productive sectors was insufficient, however, to close the gap between the greater labour supply and the lower labour demand. In most countries for which household survey data is available, the rate of open unemployment increased, as did that of unskilled, self-employed workers (see table I-3).

The structure of employment also changed in other ways. The crisis forced groups normally not part of the workforce, such as young students and married women, to join the active population. Some managed to find jobs, although not in the sectors to which they would have had access in the past; this also tended to depress wages. All these factors contributed to the frustration of the young people who had achieved higher educational levels. One of the serious results of these trends was that the proportions of young people who were neither studying nor working rose significantly, especially in the poorer urban households (see table I-4).

In addition, the results of household surveys in a number of countries of the region show that the situation of women in the workplace continued to be clearly disadvantageous.⁴ The proportion of young women ages 15-24 who had completed fewer than 10 years of study and who earned enough income to support a basic nuclear family above the poverty level was significantly lower than that of men. For young women with more than 10 years of education, the situation ranged from one where women's position resembled that of men to one where unfavourable differences amounted to around 25 percentage points. For adult women in general, it was found that those with a maximum of nine years of education earned less income for an equivalent amount of time worked than men with only five years of study. Although it might have been expected that this ratio would improve as a result of the relative rise in the educational level of young

Table I-2

LATIN AMERICA: ECONOMIC GROWTH INDICATORS, 1950-1990
(Annual rates of variation)

	1950-1960	1960-1970	1970-1980	1980-1985
Gross domestic product at market prices	5.1	5.7	5.5	1.1
Agriculture, forestry, hunting and fishing	3.5	3.4	3.5	1.8
Manufacturing	6.4	6.9	6.1	0.4
Employment in agriculture		0.2	1.1	0.7
Employment in industry		3.4	2.7	2.8
Employment in services		3.6	4.1	4.5
Output per worker		3.3	2.9	-1.7
Output per worker in agriculture		3.1	2.4	1.1
Output per worker in industry		2.4	2.9	-2.3
Output per worker in services		1.9	1.9	-2.7

LATIN AMERICA: SECTORAL PRODUCTIVITY
(1980 dollars)

	1960	1970	1980	1990
Total	3 200	4 400	5 900	4 900
Agriculture	1 050	1 450	1 800	2 050
Industries	6 400	8 100	10 700	8 300
Services	4 700	5 700	6 900	5 350

Source: ECLAC, Statistics and Projections Division for the period 1950-1980. Figures for 1980-1990 are preliminary estimates based on data provided by PREALC.

Table I-3
LATIN AMERICA (SIX COUNTRIES): CHANGES IN COMPOSITION OF EMPLOYMENT
AND INCOME FROM WORK IN METROPOLITAN AREAS

	ARGENTINA			BRAZIL			COLOMBIA		
	Percentage distribution of EAP		Variation in average income of employed workers (1980-1986) (percent-ages)	Percentage distribution of EAP		Variation in average income of employed workers (1979-1987) (percent-ages)	Percentage distribution of EAP		Variation in average income of employed workers (1980-1986) (percent-ages)
	1980	1986		1979	1987		1980	1986	
Economically active population	100.0	100.0		100.0	100.0		100.0	100.0	
Unemployed	2.3	4.5		3.7	4.8		6.6	12.5	
Employed	97.9	95.5	-2	96.3	95.2	13	93.4	87.5	7
Wage-earners	64.8	56.6	-10	73.7	76.1	15	58.7	53.7	0
Wage-earners in private sector	...	...	...	...	...	...	47.9	44.1	1
Workers in manufacturing	20.0	17.4	-9	14.7	12.2	1	12.0	8.9	1
Wage-earners in public sector	...	...	...	...	...	...	10.8	9.6	0
Non-wage-earners	32.9	38.9	9	22.6	19.1	1	34.7	33.9	13
Employers	4.9	3.8	34	3.8	3.9	19	3.4	2.8	23
Self-employed*	11.7	13.9	-17	10.9	11.0	-10	17.2	16.7	18

Table I-3 (concl.)

	COSTA RICA			URUGUAY			VENEZUELA		
	Percentage distribution of EAP		Variation in average income of employed workers (1981-1988) (percent-ages)	Percentage distribution of EAP		Variation in average income of employed workers (1981-1989) (percent-ages)	Percentage distribution of EAP		Variation in average income of employed workers (1981-1986) (percent-ages)
	1981	1988		1981	1989		1981	1986	
Economically active population	100.0	100.0		100.0	100.0		100.0	100.0	
Unemployed	7.8	6.8		7.2	8.6		5.3	8.8	
Employed	92.2	93.2	-20	92.8	91.4	-9	94.7	91.2	-13
Wage-earners	70.6	71.4	-15	70.3	67.8	-10	67.5	60.0	-20
Wage-earners in private sector	48.7	49.6	-7	50.5	49.6	-8	52.4	47.8	-20
Workers in manufacturing	10.6	9.9	-19	13.3	11.5	-5	10.3	8.5	-20
Wage-earners in public sector	21.9	21.8	-24	19.7	18.1	-13	15.1	12.2	-21
Non-wage-earners	21.6	22.0	-31	22.7	23.6	-8	27.1	31.4	14
Employers	4.2	5.0	-16	4.5	4.6	-16	3.7	5.6	21
Self-employed*	6.1	10.9	-21	9.8	9.8	-16	8.1	8.8	1

Source: Special tabulations by ECLAC on the basis of household survey data and official figures provided by the countries.

* Includes non-professional and non-technical own-account workers in all sectors of activity, except agriculture. Excludes employers and unpaid family workers.

Table I-4

**LATIN AMERICA: SOME CHARACTERISTICS OF CHANGES IN URBAN
EMPLOYMENT IN THE 1980s**

A	Percentage of dependent young males age 15-24 who neither work nor study (urban)			
	Quartile 1		Quartile 4	
Simple averages for six countries:	1980	1986	1980	1986
Metropolitan areas	19.4	22.1	3.8	4.2
Non-metropolitan areas	21.0	25.0	6.2	7.5

B	Percentage of population age 25-59 having less than six or 10 years or more of schooling			
	Less than six years of schooling		10 years or more of schooling	
	1980	1986	1980	1986
Metropolitan areas	34.2	26.9	27.9	36.8
Non-metropolitan areas	45.2	35.7	20.4	28.4

C	Percentage variation in average income of workers age 25-59 working more than 20 hours per week (urban)			
	Total	Less than six years of schooling	10 years or more of schooling	
	1980-1986	1980-1986	1980-1986	
Metropolitan areas	-11.3 %	-4.9 %	-20.1 %	
Non-metropolitan areas	-13.5 %	-11.1 %	-24.2 %	

Source: ECLAC, Statistics and Projections Division.

women, the fact is that the rise in underemployment, combined with the defenselessness of young, poorly educated working women and the growth in the number of female-headed households, produced the opposite effect.

c) *Income distribution and poverty*

A number of different factors contributed to the deterioration of income distribution in the 1980s. In some countries, unemployment, legislative changes or de facto interventions—which was detrimental to the performance of the trade unions—and new wage and social security policies led to the reduction of the real average incomes of the wage-earning population (see table I-3). In the case of the public sector, these incomes not only fell but did so in greater proportion than in other sectors. Added to this was the effect of the rise in the urban proportion of the population, combined with the greater percentage of self-employed, unskilled workers in urban areas, whose average real incomes also dropped. The increase in levels of pollution and environmental deterioration in both rural and urban sectors also aggravated real income distribution, damaging the quality of life of the poorest sectors in particular and reducing their already meager income-producing ability by adversely affecting their health.

The public-sector economy, overburdened by interest payments on external debt, suffered the brunt of the crisis. In the course of the 1980s, the public sector tended, in general, to eliminate subsidies—except in emergency situations in the financial or production sectors—, reduce the rate of job expansion, privatize public enterprises and cut down on social spending. These measures were generally prejudicial to social equity, since household income dropped as fewer jobs were created and wages fell. From the standpoint of spending, the new policies augmented the real cost of the basket of consumer goods to poor households, by raising the prices of staple foods and public-service tariffs while lowering their

quality. Some countries, however, managed to focus part of their social spending on groups living in extreme poverty.

In most countries, wages as a proportion of GDP plummeted. This was not true, however, of gross earned surpluses; after subtracting payments abroad, they remained in the hands of nationals and not only stabilized but in some cases actually rose. This result is consistent with the available household survey data, for the wages and incomes of unskilled, self-employed workers severely contracted, while employers' earnings were less harshly affected and sometimes even increased (see table I-3). In most countries, real minimum wages fell, and the decrease tended to be greater than the drop in average wages (see table I-4). Figures for a group of countries around 1980 and 1986 show that in most cases the gap between well-being and poverty widened, since the incomes of the lower three quartiles of the population dropped more than did those of the highest quartile (see table I-5), while the incomes of the richest 5% remained the same or increased (see figure I-1).⁵

Since about 70% of the income of urban households living near the poverty line comes from salaries, wages and remittances from abroad, whose purchasing power generally drops significantly in crisis periods, it is not surprising that the percentages of the population living in poverty and indigence increased, as opposed to the predominant trend during the three post-war decades (see table I-6). It is estimated that the percentage of poor households rose in the 1980s, and that this increase was concentrated in the urban areas, although the indigent proportion of the rural population also grew. Thus, by the end of the decade, and unlike in other developing regions, most of the poor lived in urban areas, while most of the extremely poor lived in rural areas.

d) *Social services*

In the 1980s, improvements in the basic health and education indicators stand in contrast to the financial crisis of the public sector and to

Table I-5
LATIN AMERICA (SIX COUNTRIES): DISTRIBUTION OF HOUSEHOLD INCOME, BY
QUANTILES OF PER CAPITA HOUSEHOLD INCOME

Country/year		Index of average household income	Income share (%)				Average per capita income expressed in terms of relationship to poverty line				Gini coefficient	Coefficient of average incomes		Households with below-average income (%)
			Quartiles				Quartiles					Richest 25% / poorest 25%	Richest 10% / poorest 40%	
			1	2	3	4	1	2	3	4				
Argentina	AM 80	100	9.3	15.8	24.1	50.8	1.3	2.4	3.9	10.1	5.5	6.8	66	
	AM 86	94	8.8	14.4	22.3	54.5	1.1	2.1	3.5	10.5	6.2	8.5	74	
	AM 79*	100	5.6	12.1	20.1	62.1	0.7	1.5	2.9	11.7	8.9	17.1	73	
	AM 87*	107	4.9	10.4	18.1	66.6	0.6	1.4	2.8	13.1	13.7	17.4	78	
	Urb 79	100	5.6	11.5	19.7	63.3	0.5	1.1	2.1	8.2	11.2	13.4	75	
	Urb 87	100	4.4	10.3	19.1	66	0.4	1	2	8.7	15.1	17.4	75	
	Rur 79	100	8.1	15.5	22.3	54.1	0.3	0.6	1	3.2	6.7	8.4	72	
	Rur 87	115	6.6	13.1	20	60.3	0.3	0.7	1.1	4.1	9.2	11.5	75	
	AM 80	100	5.7	12.4	21.8	60.1	0.3	1	1.9	5.2	10.6	12.1	75	
Colombia	AM 86	110	5.8	13	22.1	59.1	0.4	1.1	2	6.2	10.2	11.6	73	
	Urb 80	100	5.3	13.1	22.3	59.3	0.3	0.7	1.3	4	11.2	11.8	72	
	Urb 86	125	5.5	14.1	23.9	56.5	0.4	0.9	1.7	5	10.3	10.4	72	

Table I-5 (concl.)

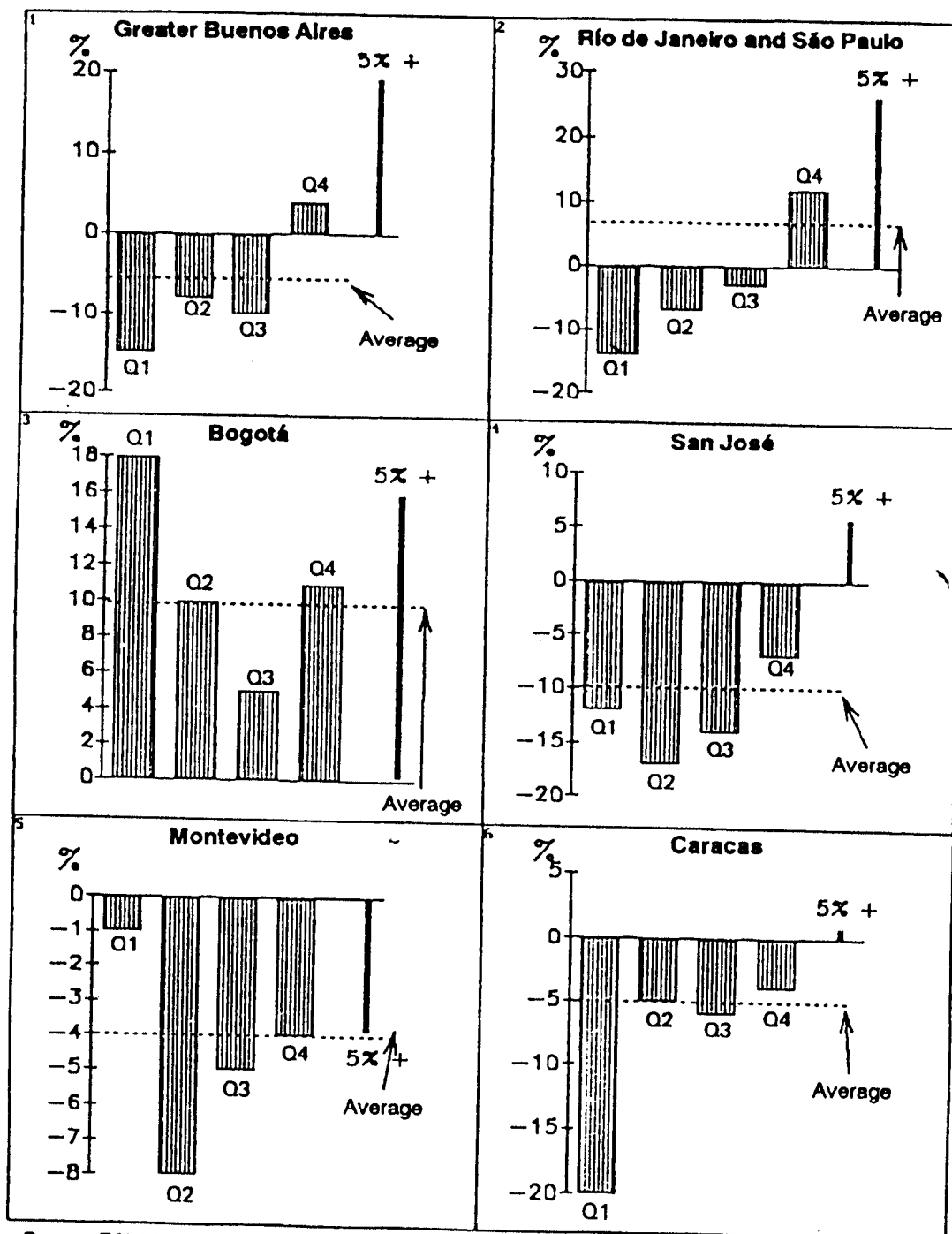
Country/year	Index of average household income	Income share (%)				Average per capita income expressed in terms of relationship to poverty line				Gini coefficient	Coefficient of average incomes		Households with below-average income (%)	
		Quartiles				Quartiles					Richest 25%/poorest 40%	Richest 10%/poorest 40%		
		1	2	3	4	1	2	3	4					
Costa Rica	AM 81	100	9.3	16.1	27.1	47.5	0.8	1.8	2.9	6.7	0.34	5.1	5	66
	AM 88	90	8.5	16.5	25.8	49.3	0.7	1.5	2.5	6.2	0.36	5.8	6.2	68
	Urb 81	100	9.6	17.5	27.1	45.8	0.8	1.7	2.8	6.1	0.32	4.8	4.7	66
	Urb 88	86	8.5	16.2	25.2	50.1	0.7	1.3	2.2	5.3	0.36	5.6	6.4	67
	Rur 81	100	7.9	17.3	26.4	48.4	0.6	1.3	2.3	5.7	0.36	6.1	6	66
	Rur 88	92	7.8	17	26.4	48.8	0.6	1.3	2.1	5	0.36	6.3	6.2	66
Uruguay	AM 81	100	10.1	16.2	22.8	50.9	1.3	2.5	4	9.8	0.35	5	6	68
	AM 89	95	10.5	15.8	23.3	50.3	1.3	2.3	3.8	9.4	0.35	4.8	5.8	69
	Urb 81	100	10.5	16.4	23.3	49.8	1	2	3.2	8	0.34	4.7	5.7	67
	Urb 89	86	11.1	16	20.4	52.5	0.9	1.7	2.6	6.9	0.36	4.7	6.6	72
	AM 81	100	8.3	17	24.9	49.8	1	1.9	3.4	9.7	0.37	6	5.3	64
	AM 86	95	7.6	15.5	24.6	52.3	0.8	1.8	3.3	9.4	0.39	6.8	7.2	67
Venezuela	Urb 81	100	9.4	18	27.1	45.5	0.7	1.5	2.5	6.1	0.32	4.8	4.4	67
	Urb 86	78	8.1	16.4	25	50.6	0.5	1.1	1.8	4.7	0.37	6.2	6.4	67
	Rur 81	100	10.2	19	26.6	44.3	0.5	1.1	1.8	4.5	0.29	4.4	4	67
	Rur 86	90	9	15.8	24.6	50.6	0.4	0.9	1.5	4.2	0.37	5.7	6.7	69

Source: ECLAC, Statistics and Projections Division.

* Average of metropolitan areas of Rio de Janeiro and São Paulo.

Figure I-1

LATIN AMERICA (SIX METROPOLITAN AREAS): PERCENTAGE VARIATION OF HOUSEHOLD INCOME OF VARIOUS SOCIAL STRATA IN THE 1980s



Source: ECLAC estimates based on special tabulations of household survey data.

Q1 : The quartile of households with lowest income.

Q2 : The quartile of households above the median.

Q3 : The quartile of households below the median.

Q4 : The quartile of households with highest income.

5%+ : The 5% of households with the highest income.

Table I-6
LATIN AMERICA: SOCIAL DEVELOPMENT INDICATORS,
1950-1990

	1950-1955	1960-1965	1970-1975	1980-1985	1985-1990
Life expectancy at birth (years)	51.8	57.2	61.2	65.3	66.7
Infant mortality (per thousands live births)	127.7	103.2	80.8	76.9	59.8

	1950	1960	1970	1980	1990
Illiteracy (% of population age 15 or over)	44.0	35	29	23	15.3
Enrolment ratios, ages 6-11		64.7	71.0	82.3	87.3
Gross enrolment ratio, secondary level		18.7	31.6	47.4	54.9
Percentage of dwellings with drinking water		33	49.5	66.3	
Percentage of population living in cities	41.1	49.3	57.4	65.3	71.9
Percentage of households living in poverty			40	35	37 *

Source: ECLAC, Statistics and Projections Division.
* 1986.

downward pressures on social spending. In the case of health, infant mortality in the region dropped from 80.8 per 1 000 live-born at the beginning of the 1970s to 59.8 by the end of the 1980s, while life expectancy at birth rose from 61.2 to 66.7 years during the same period (see table I-6). These figures, however, although certainly representing notable progress, mask situations where the tragedy of poverty continues to be felt with extraordinary force. Malaria, for example, increased significantly in the 1980s. In view of the characteristics of the vectors which transmit the disease, this fact is a clear example of how environmental deterioration affected the region's poor population with special virulence. In many instances, efforts were made to enhance the efficiency of spending, or to incorporate low-cost, highly effective technology, as in the case of primary health care and vaccinations. These to some extent counteracted the effect of the reduction or only slight increase in per capita government social spending, although the quality of benefits often deteriorated as a result of the decline in maintenance spending or the lower real wages of health sector personnel.

Trends in educational systems in the 1980s display a contrast of achievements and failures. The former include, in particular, the raising of the educational level of the population (see table I-6). This advance is reflected in the increase in the proportion of children receiving pre-school education and, in general, in the rise in the average number of years of schooling for all age groups. Indicators of school leaving, non-attendance and retention also improved.

Despite these advances, unequal access to education on the part of different population sectors, which had already manifested itself in the previous decade, persisted, as did differences—in terms of educational achievements—between high- and low-income groups and between urban and rural residents (see table I-7). In this sense, the cutback of public spending on education presages a grave risk in the coming years, since the worse the quality of public education and the more the higher-income strata choose private schooling, the more the stratified

circuits of education, jobs and well-being will tend to consolidate.

Table I-8 shows the positive correlation between educational level and income, but also indicates that this relationship became less marked as a result of the crisis of the 1980s; thus a high educational level did not always serve as a defence against the deterioration of living conditions. These figures also reflect the drop in income of vast middle-income sectors, such as salesworkers, administrative employees in private firms and, especially, civil servants. Educational level had less impact on income trends among these workers in the last few years than the simple fact that they were wage-earners. Consequently, the rise in the number of poor and indigent in the 1980s, mainly in the cities, was compounded by the greater economic and social vulnerability of the middle classes, even though their educational levels were higher than average (see table I-4). Added to these factors was the combination of greater inequity—as reflected in less effective access to goods and services—with the growing outreach of the mass communications media, whose immediate effect was to tend to standardize the region's expectations and bring them closer to those prevailing in the developed countries.

e) *Natural resources*

The distribution of capital and access to natural resources, including land, are very indicative of the degree of social equity that exists in a given society. Unlike the public and industrial sectors, and because public policy was no longer so negatively biased against rural areas, the agricultural sector grew, although moderately, in the 1980s. Agricultural modernization, however, which enabled landholders to expand their scale of production, often reduced rural workers' access to the land which they were renting or farming as sharecroppers. Access to land continued to be a fundamental factor, but the latifundio-minifundio system tended to disappear, and the relationship between farm owners and peasants or workers

Table I-7

**LATIN AMERICA (SIX COUNTRIES): AVERAGE YEARS OF SCHOOLING BY QUANTILES
OF HOUSEHOLD INCOME, BY AGE GROUP, AREA AND YEAR**

COUNTRY	YEAR	CHILDREN (AGES 10-14)				YOUNG ADULTS (AGES 15-24)			
		TOTAL	QUARTILE 1	QUARTILE 4	QUARTILE 4	TOTAL	QUARTILE 1	QUARTILE 4	QUARTILE 4
ARGENTINA Buenos Aires *	1980	5.3	5.0	6.0		9.5	8.0	10.9	
BRAZIL Metropolitan area	1979	3.2	2.5	4.5		6.5	4.7	9.1	
	1987	3.5	2.9	4.5		7.4	5.7	9.9	
COLOMBIA Bogotá	1980	4.0	3.4	5.3		8.0	6.7	9.8	
	1986	4.5	4.1	5.1		8.6	7.4	10.0	
COSTA RICA San José	1988	4.6	4.1	5.2		8.9	7.6	10.5	
URUGUAY Montevideo	1981	5.1	4.6	5.5		9.0	7.4	10.2	
	1989	5.2	4.9	5.8		9.5	8.3	11.0	
VENEZUELA Metropolitan area	1981	5.1	4.7	5.8		8.5	7.6	10.1	
	1986	5.0	4.4	5.7		8.9	7.9	10.8	

Source: ECLAC, Statistics and Projections Division.

* Greater Buenos Aires.

Table I-8

**LATIN AMERICA (SIX COUNTRIES): EARNED INCOME AND
EDUCATIONAL LEVEL^a**

COUNTRY	YEAR	TOTAL	0-5 YEARS	6-9 YEARS	10 YEARS OR MORE
ARGENTINA^b Buenos Aires	1980	8.9	5.6	7.4	14.2
	1986	6.3	4.8	5.7	8.3
BRAZIL Metropolitan area	1979	6.7	4.1	6.6	13.6
	1987	7.3	3.8	5.5	13.7
Urban	1979	6.2	4.0	7.2	13.5
	1987	6.5	3.7	6.0	12.9
Rural	1979	3.1	2.8	6.5	12.4
	1987	4.4	3.9	7.9	11.7
COLOMBIA Bogotá	1980	4.9	2.2	3.3	9.7
	1986	4.7	2.7	3.4	6.8
Urban	1980	4.2	2.3	3.9	8.3
	1986	4.4	2.9	3.7	6.6
COSTA RICA San José	1981	7.7	4.6	5.9	10.7
	1988	5.9	3.4	4.2	7.9
Urban	1981	7.8	5.5	6.2	11.5
	1988	5.6	4.0	4.4	7.1
Rural	1981	7.9	7.0	7.5	13.8
	1988	6.0	5.4	5.7	8.3

Table I-8 (concl.)

COUNTRY	YEAR	TOTAL	0-5 YEARS	6-9 YEARS	10 YEARS OR MORE
URUGUAY Montevideo	1981	6.8	4.4	5.4	9.5
	1989	5.8	3.6	4.6	7.4
	1981	5.6	4.3	5.3	7.7
	1989	4.3	3.4	3.9	5.5
VENEZUELA Metropolitan area	1981	9.0	6.5	8.1	12.4
	1986	8.5	4.6	6.1	12.2
	1981	8.2	5.8	7.8	12.3
	1986	6.1	4.3	5.4	8.7
	1981	7.4	6.1	9.2	16.3
	1986	5.7	4.7	6.1	13.4

Source: ECLAC, on the basis of household surveys conducted in these countries.

- ^a Average of monthly equivalent earned income capacity. Monthly equivalent of hourly wage divided by per capita value of poverty line. Includes wage-earners age 25-59 who work more than 20 hours per week.
- ^b Corresponding education brackets are: incomplete primary; complete primary and incomplete secondary; and complete secondary or higher.

became restructured through the labour market. Thus, segmentation of rural populations began to consolidate into a system consisting of a class or estate of wage-earners on the one hand and a class of landed peasants on the other, often conditioned by the minifundio system. The economic position of both estates has become unstable, both in labour markets and in the markets for land, finance, technological inputs and farm products.

The situation worsened, and its negative impacts on social equity became more marked, since the peasants' limited access to the land market led to their physical segregation on marginal land, which is constantly being subdivided. The pressure exerted by the peasant population on this land entails an over-exploitation of the soil and a consequent depreciation of natural capital. The reduced yield associated with this depreciation leads to even greater over-exploitation for reasons of simple survival, continuing a vicious circle of poverty, environmental deterioration and extreme poverty.

The crisis of the 1980s was also associated with a significant and probably irreversible trend towards capital redistribution and concentration. In the first place, when the international banks gained a presence in Latin America and the Caribbean, while the region was gradually being incorporated into an international environment characterized by the growing predominance of international financial flows in a number of countries, an intensive transfer of natural resources began to occur among domestic groups, taking advantage of the easy access to foreign credit. This helped increase the relative importance of financial assets as compared to physical assets.

In the second place, external agents found it easier to buy national assets and gain access to natural resources. In some cases this transfer of assets, directly or indirectly associated with external indebtedness, may have been intensified by the fact that it occurred at prices that were below real market value.

Finally, the importance of private capital increased compared to public capital in some

areas related to physical infrastructure (transport, electricity, telecommunications, drinking water) or the industrial base (steel, petrochemicals). Public enterprises registered losses or low profits because they transferred earnings to their users through subsidized pricing. Thus their privatization put an end to many subsidies and changes in relative prices, which altered the distribution of resources and aggravated the problem of poverty, as noted above.

f) *Final remarks*

Despite the seriousness of the problem of social equity and the fact that it worsened in the 1980s, two factors are likely to save the way to future advances. Firstly, the sharp drops in fertility rates in most countries of the region since the mid-1960s or 1970s will involve a relative lessening of the need for job creation in the 1990s. Growth and investment requirements for the productive absorption of new members of the labour force will be reduced, thus releasing resources for a more productive absorption of the many who were forced to take jobs with little or no productivity during the crisis of the 1980s. Moreover, as the number of persons requiring educational, nutritional and mother and child care services declines with the drop in population growth rates, less financial effort will be needed to improve the quality of these services.

Secondly, the organization of social services in many countries has traditionally paid little attention to considerations of efficiency. This means that, often at fairly low cost, substantial progress can be made both in terms of expansion of coverage (a crucial matter in many countries of the region) and in terms of higher quality standards. Measures to streamline and restructure social services could be designed for immediate effect, such as prioritizing and focusing attention on certain areas, and broader structural changes could be made, such as decentralization and the promotion of financial autonomy, which would yield benefits only in

the long run. One way or the other, steps could be taken to provide domestic incentives to improve the quality of attention and cut costs.

Notes

¹ See ECLAC, *Changing Production Patterns with Social Equity*, *op. cit.*

² *Ibid.*, pp. 79-81.

³ See ECLAC, *Panorama social de América Latina. Edición 1991*, *op. cit.*, and *Nota sobre el desarrollo social de América Latina* (LC/G.1665), Santiago, Chile, July 1991, document presented at the First Ibero-American Summit of Heads of States and Government, Guadalajara, Mexico, 18-19 July.

⁴ ECLAC, *Social Panorama*, *op. cit.*

⁵ Colombia was an exceptional case, probably because of its more modest external deficit, together with an increase in the minimum wage as adjustment policies were more strictly applied.

Chapter II

THE INTERNATIONAL SCENARIO

1. Introduction

The document *Changing Production Patterns with Social Equity* emphasized the vital importance of domestic efforts to design new policies, make institutions functional, mobilize resources and achieve a national consensus. It also recognized that these efforts were, to a large extent, a response to the need to adapt to the changing external environment. The document, therefore, presented the secretariat's view of how the international economy was evolving and the main trends that could affect the countries of Latin America and the Caribbean in future.¹

In the two years since that study appeared, the international context has continued to change with amazing rapidity. Even though the region has responded energetically to external upheavals in other periods of its economic history—for example, by adopting an industrialization strategy, in part as a response to the events of the 1930s and 1940s—there is no comparison between the present moment and the past, with respect to the intensity, speed and scope of the changes taking place. Among other aspects, the end of ideological warfare, one of the main characteristics of the post-war world, has completely overturned all previous views about global political and economic relations.

There is no need to give a detailed list of the characteristics of those events and describe their scope, since they have been explored in numerous publications of the United Nations and of ECLAC itself.² This study, however, would

be incomplete if it failed to examine some of the external conditioning factors that could decisively influence how the countries of Latin America and the Caribbean approach the policies and actions proposed in the following chapters.

2. The globalization of economic activity

Globalization is one aspect of a broader phenomenon that affects every dimension of the human condition: demography, poverty, employment, endemic diseases, drugs and the environment, among others. Many spheres of economic activity have become markedly transnational, owing largely to the enormous growth of information technologies. The extension of these technologies to design, production, distribution and marketing makes it possible to shorten the period between design and production, allowing for a much more rapid response than was previously possible to new real or induced demands. Lower communication and transportation costs have only speeded up this trend.³

The deregulation of financial markets, coupled with the new technologies, has helped to create a vast world market of funds and financial instruments that process a much greater volume of transactions than those involved in merchandise trade. This has an impact on the behaviour of exchange and interest rates, and therefore, on the relative competitiveness of economies.

Networks of transnational production systems have been developed as a result of the expansion of the sphere of influence of transnational corporations, the formation of strategic alliances among these corporations (including those belonging to different sectors), and the widespread use of worldwide information and communication networks. Transnational corporations have become increasingly important as basic economic actors, in view of their ever-increasing share of world trade. This fact stems from a crucial phenomenon: their ability to centralize the planning and control of enterprises, while production is decentralized and subdivided geographically to take advantage of resources, costs or location. This is true not only of goods, but especially of services. Also worthy of note is that the comparative advantages of a given country can change instantly depending on the decisions taken by global enterprises concerning their production and distribution activities.

Innovations based on microelectronics and new materials are lessening the developing countries' traditional comparative advantage of cheap labour and various types of raw materials. Other trends in the field of energy resources and environmental protection also have clearly transnational features.

All the foregoing events have made the world intensely competitive. The traditional way of ordering international economic relations—basically through regulations applied on the borders between countries—has become increasingly irrelevant, compared to other factors previously regarded as matters of domestic economic policy alone. For example, macroeconomic management at the national level, quality norms and standards or environmental regulations can have more of an impact on the structure, volume and flows of international trade than the type and amount of tariff or non-tariff restrictions on imports.

On the other hand, the globalization of economic activity tends to create a certain uniformity in the formulation and application of policies, since each country becomes a competitor for finite markets and scarce

resources. Attention to market signals, promotion of international competitiveness, development of entrepreneurial skills and attraction of direct investment are therefore becoming common elements of the efforts being made by nations to improve their international position.

As is well known, along with the changes in the economic environment, even more extraordinary political events are taking place. These events would normally be accompanied by wide-ranging changes in international relations, and these, in turn, would have economic effects. Thus, for example, the end of the cold war, by lessening the major industrial countries' concern for military security, could make it possible to divert defence expenditures towards socially productive ends—among them, international cooperation—or at least make it easier to balance the budget of the main developed economies, which would also have favourable effects on the world economy. The framework that is taking shape is still a long way from the new international economic order called for by the region barely 15 years ago,⁴ but there is no denying that it points to a new order, as opposed to the one prevailing between 1945 and 1980.

3. Alternative scenarios for the world economy

There is a clear dysfunction between existing multilateral institutions (created precisely in the period immediately following the war) and the way in which enterprises and nations interact with the world economy today. Multilateral negotiations under the General Agreement on Tariffs and Trade (GATT) and the growing relevance of GATT for the region (the number of member countries from Latin America and the Caribbean has grown from 16 to 23 since 1987) are only a first, hesitant step towards correcting that situation. Another step was the decision taken by certain groups of countries to further their efforts to become more quickly integrated into the global community of nations.

A key question for Latin America and the Caribbean is how the more important countries of the world economy might react to the above-mentioned trends. On the one hand, they might adapt their national policies to the new objective realities produced by these trends, which would mean that policies were becoming more and more similar and that a more open, integrated economy was coming into being. On the other hand, these economies might resist the trends in order to defend their own national interests. That would mean a return to greater protectionism and more attempts to administer trade and financial flows.

The first reaction would no doubt lead to a more open, transparent world economy, characterized by increased transborder mobility of factors; the second would result in a more divided world, involving integration within the large blocs of countries now being formed (the European Community, the North American Free Trade Zone) and a better administration of trade between blocs. Since the international competitiveness of the Latin American and Caribbean economies is the core of the process of changing production patterns with social equity, the degree of access to markets in either of these scenarios is clearly a variable of prime importance.

These two scenarios stand at opposite poles, with a whole range of possibilities in between them.⁵ Two empirical observations can be made. First, even if the moderate advances achieved with great difficulty in the Uruguay Round, had satisfied the most optimistic expectations, they still would have been insufficient as an institutional response to the globalization of economic activity. Second, both the agreements arrived at in the European Community at the end of 1991 and the probable expansion of the free trade zone between Canada and the United States to include Mexico in the near future, are clear signs of a trend towards the formation of large groups of countries in the framework of customs unions, free trade zones or integration processes.

These two empirical data are interrelated. The effort to integrate groupings of "blocs" of

countries could be interpreted as a partial and selective response —among countries with greater political affinity— to the institutional demands of economic globalization. Put another way, it is easier to align policies and adopt common norms and rules among a limited number of relatively homogeneous countries (for example, the members of the European Community), than among the more than 100 heterogeneous countries which currently participate in GATT.

The formation of blocs of countries is not necessarily, however, an impediment to progress towards a more integrated world economy, as demonstrated by the more ambitious objectives put forward by the promoters of the Uruguay Round. Those efforts may well be seen as intermediate steps. Indeed, the authorities of the member countries of the European Community and those of the United States and Canada have held that their integration processes will help invigorate world trade, and available information on the intraregional and extraregional trade of both groups tends to support that assumption.⁶

In any case, it is vital for Latin America and the Caribbean to find out whether the common markets, customs unions and free trade zones will become the *foundations* of an integrated world economy or rather *hurdles* that will be sources of division. The former is clearly more favourable for the region, but it is interesting to note that a conceptual justification could be found in either of the two hypotheses for furthering Latin American integration and eventually forming a free trade zone covering the whole hemisphere.

4. The present situation of the world economy and outlook for the medium term

a) *Trade regulations*

The trend towards the alignment of a series of public measures and policies which go beyond the strictly trade sphere can be seen both at the multilateral level —mainly in the trade

negotiations of the Uruguay Round— and at the level of blocs of countries, especially with the development of economic spaces which are expanding through integration.

i) The Uruguay Round and its after-effects

The programme of the Uruguay Round was much more ambitious than the previous rounds of GATT. Despite substantial reductions of tariffs achieved up to that time, considerable tariff barriers still existed for some sectors and products. The 1980s saw a certain proliferation of protectionist measures in those sectors and countries, mostly in developed countries, which were suffering the consequences of having to adjust to new competition in the world economy. The protectionist measures were quasi-tariffs rather than tariffs, for the most part, anti-dumping controls and duties, countervailing duties and voluntary restrictions on exports were used as instruments of discrimination, by-passing GATT rules. The purpose of the Uruguay Round was to make these practices subject to more strict norms and criteria, as well as to achieve greater tariff liberalization.

But the Round's mandate went even further. For the first time, a round of trade negotiations included topics such as the rules governing intellectual property, the treatment of foreign capital, and the services sector.

Among other points, the Round dealt with the following: a) subsidies used by countries to maintain the living standards of their rural populations, to attain food self-sufficiency or to promote investments needed for economic development; b) measures to ensure that foreign investment effectively contributes to development and to offset the restrictive trade practices of transnational corporations; and c) measures concerning the protection of intellectual property, which are needed by less technologically developed countries to alleviate poverty, promote public health and meet the nutritional needs of their populations. Carried to the extreme, the final result of the harmonization

process would be that national markets would become elements of a global market.

The conclusion of the Uruguay Round clearly does not exhaust all the trade questions that could be addressed at the international level. The wide range of issues dealt with in the Round, together with new topics such as the environment, make it necessary to keep trying to combine multilateralism and reciprocity, the basic pillars of GATT, in the interests of a gradual liberalization of trade at the international level, with clear, better rules which protect all parties —especially the weaker ones.

Unlike the trade policies of developed countries, whose aims include increased protection for a number of key commodities or the limitation of trade liberalization to a specific geographic area, the Latin American and Caribbean countries have made great efforts to liberalize trade unilaterally, without exclusions. These efforts include drastic tariff reductions and the elimination of non-tariff barriers (see table II-1). Average tariffs, which had reached more than 45%, have been lowered to present levels of below 20%, and efforts have been made to lessen tariff dispersion. That has made it possible to reduce the number of brackets to between three and seven; this represents a significant advance, since several countries had more than 30. Moreover, some countries are moving towards uniform tariff levels. Import quotas, permits, licenses, prohibitions, national content requirements and prior deposits have all been eliminated or made much more flexible. These advances comprise a solid argument that the region should have non-discriminatory access to extraregional markets of goods and services.

On the basis of these efforts, the region as a whole called on the other countries in the Uruguay Round to recognize that this liberalization deserved the recompense of greater access to other markets. Thus, based on example instead of rhetoric, Latin America and the Caribbean have become leaders in multilateral trade liberalization. The most direct way in which the region can contribute to a non-discriminatory international economy will be to

Table II-1
LATIN AMERICA: PROCESS OF TRADE LIBERALIZATION

Country	Beginning of programme	Maximum tariff			Number of brackets			Average tariff		Non-tariff barriers	Notes
		Initial	Present	Pro-grammed	Initial	Present	Pro-grammed	Initial	Present		
Argentina	1987	115	22				4	43 <u>a/</u>	9 <u>a/</u>	In 1987-1988, the value of industrial output subject to restrictions was reduced from 62% to 18%. In 1989-1990, the remaining licensing restrictions were eliminated. The deregulation decree at the end of 1991 reduced non-tariff requirements to security and sanitation controls and removed the restriction called "buy Argentinean".	Liberalization began in 1987 and accelerated in 1989. Besides tariff reductions, other temporary and specific duties were eliminated. At the end of 1991, tariffs were raised from 0% to 5% for foodstuffs and raw materials, and from 11% to 13% for intermediate goods. The initial tariff includes the surcharge.
Bolivia	1985	150	10			1	1	12 <u>b/</u>	10 <u>b/</u>	All prohibitions and license requirements on imports were abolished, with the exception of controls on sugar and wheat, and on goods that affect health and endanger State security.	Before liberalization, quantitative restrictions and the differentiated tariff structure represented high barriers against imports.
Brazil	1988	105	85	40	29	7	7	51 <u>c/</u>	25 <u>c/</u>	In 1990, the list of prohibited imports (annex C) was abolished. Nevertheless, 47 computer-related products will not be allowed to be imported until 1992, and local-content rules for intermediate and capital goods will be maintained.	Tariffs began to be restructured in 1988-1989. The present programme was introduced in 1990; it will gradually reduce tariffs until it reaches a maximum tariff of 40%, a mode of 20% and a median of 14% in 1994.
Colombia	1990	100	23	15	14	4	4	37 <u>b/</u>	14 <u>b/</u>	Prior-licensing restrictions were almost completely eliminated at the end of 1990, except for certain products produced by State monopolies (arms) or covered by international treaties (inputs related to drug traffic) and certain agricultural products.	The process of tariff reduction initially programmed for 1993 was advanced to August 1991. This tariff includes the surcharge, which is now 8% (it was previously 10%) and it will be eliminated in 1992. The tariff for automobiles is 75%.
Costa Rica	1986	220	40	20				27 <u>c/</u>	20 <u>c/</u>	Gradual elimination of import permits and other restrictions in the 1990-1994 period.	Tariffs above 40% are still applied to some items (among them, automobiles, with a tariff of 100%), but they are a small percentage of the total. The maximum tariff will be reduced to 20% in 1992 for most products.

Table II-1 (cont.)

Country	Beginning of programme	Maximum tariff			Number of brackets			Average tariff		Non-tariff barriers	Notes
		Initial	Present	Programmed	Initial	Present	Programmed	Initial	Present		
Chile	1973	220	11		57	1	1	94 g/	11 g/	Quantitative import restrictions were eliminated in the 1970s, with the exception of those on second-hand automotive vehicles, and sanitation and phytosanitation controls on a broad range of agricultural products.	In response to a balance-of-payments crisis, the uniform tariff of 10% was raised to 20% in 1983 and 35% in 1984. It was then reduced in successive stages to 15% in 1988 and 11% in 1991.
Ecuador	1990	290	35					53 g/	25 g/	Quantitative import restrictions are in the process of being eliminated, with the exception of those on vehicles and on chemical substances that can be used to produce illicit drugs. Prior deposits for imports were abolished.	The tariff for vehicles is 40%, but the prohibition to import them is being maintained.
El Salvador	1989		30	20	20	7				Prior deposits for imports and several laws favouring certain sectors were abolished.	The maximum tariff will be gradually reduced to 20% in 1994 (with a few exceptions).
Mexico	1985	100	20		10	5	5	24 a/	12 a/	Coverage of import licenses was reduced from 92.2% of production in June 1985 to 17.9% in December 1990, and government import prices were eliminated. Prior licenses were maintained for some agricultural and food products, petroleum and its by-products and some products used in industrial development programmes.	The surcharge of 5% was eliminated in December 1987. The customs system was reformed.
Peru	1990	110	25	15	53	3	1	66 g/	17 g/	Licenses, controls, import permits, quotas and prohibitions were eliminated in March 1991.	The programme began in August 1990 when the maximum tariff of 50% was established. It went further in March 1991, when the maximum tariff was reduced to 25% for consumer goods and 15% for the rest (80% of all imports). The initial tariff includes the surcharge.
Uruguay	1974	346	30		>30	3	3		22 g/	Import quotas and licenses were abolished in 1975, and requirements on terms of financing and controls on imports of capital goods, in 1977. Benchmark prices were maintained for some products.	Tariffs have been slowly coming down since 1974. This process speeded up in 1979, but stopped between 1982 and 1986. The most recent reductions were made in September 1991.

Table II-1 (concl.)

Country	Begin- ning of pro- gramme	Maximum tariff			Number of brackets			Average tariff		Non-tariff barriers	Notes
		Initial	Present	Pro- grammed	Initial	Present	Pro- grammed	Initial	Present		
Venezuela	1989	135	40	20	41	6	3	35 ^{b/}	10 ^{b/}	The number of headings subject to restriction was reduced from 2 204 in 1988 to 200 at present.	Specific duties were eliminated; in some cases they carried the maximum tariff of 940% before the liberalization programme was put into effect. The tariff reduction programme will be completed in 1993.

Source: ECLAC, on the basis of country figures.

^{a/} Weighted by domestic production.^{b/} Weighted tariff on imports.^{c/} Simple average based on tariff items.

continue making efforts to set norms and liberalize trade within a multilateral context; this endeavour will strengthen GATT, which needs, among other elements, more apt mechanisms for resolving differences and more clout to enforce its regulations.

ii) *The development of economic spaces*

The Uruguay Round has shown how difficult it is to align policies and regulations among the heterogeneous group of more than 100 member countries of GATT, each with a different level of development. As already mentioned, such a process is more viable for a limited number of like countries. Efforts have intensified over the last two years to consolidate regional economic spaces and bilateral agreements between countries. The creation of such spaces, along the lines of free trade zones, preferential agreements and customs unions is recognized and accepted with certain conditions by the General Agreement on Tariffs and Trade itself, even though it transgresses the principle of non-discrimination, which is the cornerstone of GATT.

a. *The consolidation of Europe.* The most advanced example of this process of alignment and integration is the European Economic Community. In 1990, the Community ended its preparation of legislative proposals for putting into effect the single European market on 1 January 1993, which involves eliminating all national barriers to the free movement of merchandise, services, persons and capital by that date. To do so, the Community programme intends to adopt 282 common provisions and directives, most of which have already been approved of by the Council of the European Economic Community. The final result will be to achieve the standardization of norms in areas as diverse as processing, packaging and labelling of products; the waste industry; government procurements; services; movements of capital; consumer protection; taxation; activities of private enterprises; sanitation and phytosanitary controls; trade and transport documentation and

procedures; free movement of workers and recognition of professional degrees; and rules and procedures for industrial inspection and certification.

The Community's consolidation process, which also includes programmes for economic and monetary union and political integration, has had a decisive effect on the surrounding countries. The European Community and the European Free Trade Association (EFTA) recently agreed to widen the single market, which paved the way to constituting a European economic zone from the Arctic Sea to the Mediterranean. Likewise, even though the events in Central and Eastern Europe also contributed to the dissolution of the Council for Mutual Economic Assistance (COMECOM), its former member countries now revolve around the Community, which has removed some of the restrictions to imports from those countries. Three of them have expressed their desire to sign associative agreements with the EEC, which could eventually lead to full membership.

Since the European integration process is taking place at two different levels —the incorporation of new members and the strengthening of integration among older members— the Community of the future has been described in terms of "concentric circles". Other circles can be added to these two: the Mediterranean countries with which the Community has signed preferential agreements, and the countries of Africa, the Caribbean and the Pacific linked to the Community by the Lomé Convention. This would constitute a wide economic space around the EEC.

The European integration process could move in two directions: it could give impetus to the world economy and to international integration being furthered by globalization, or it could become a relatively closed space in which the free internal movement of goods, services and factors is offset by greater implicit or explicit restrictions for the rest of the world.⁷ The first-mentioned scenario now seems to be prevailing for trade, although restrictions on immigration seem to reflect pressures to reduce the mobility of manpower from other regions.

Thus, with respect to trade, the European integration process has led to an increase in United States exports to the Community market, with a spectacular expansion of almost 100% between 1986 and 1990. It can be supposed that, given the same circumstances, the single market planned for Europe in 1993 will make it even easier for other countries to trade inside that vast economic zone, in which, moreover, corporate-driven demand will increase as investment increases.⁸ Fixed investment by European enterprises is expected to more than treble between 1985 and 1995. The countries of Latin America and the Caribbean should take advantage of this greater potential demand by negotiating trade agreements to facilitate access to the European market and continuing their efforts to enhance the competitiveness of the region's exportable supply.

b. *The Enterprise for the Americas Initiative.* A similar though less advanced process is taking place on the American continent. An agreement between the United States and Canada to create a free trade zone over a period of 10 years came into effect in January 1989. In June 1991, negotiations were begun to extend this zone to Mexico.

To extend this economic space to the whole hemisphere, "from Alaska to Tierra del Fuego", is a long-term objective of the Enterprise for the Americas Initiative announced by the President of the United States in June 1990. The United States has already arrived at basic agreements with most of the countries of Latin America, individually and collectively, as in the cases of the Southern Cone Common Market (MERCOSUR) and the Caribbean Community (CARICOM).

Pursuant to the declaration which launched the Initiative, these basic agreements stipulate the principles on which future formal agreements should be based, and they provide for the establishment of a mixed agency, normally called a Trade and Investment Council, which forms the core of the relationship between the parties. These principles deal mostly with the same issues that were negotiated in the Uruguay Round. Among them, as successive declarations

have noted, are trade liberalization, including trade in services between the parties; coordination of actions in multilateral trade negotiations, particularly to ensure the complete success of the Uruguay Round; the recognition that investors from each party will receive the same treatment as national citizens in the territory of the other party; abstention from imposing requirements on the investments of the other party which would distort trade, and the protection of the intellectual property rights of the citizens and enterprises of the other party.⁹

The negotiation of free-trade agreements with the United States, although it involves compromises on both sides, undoubtedly holds potential. In order to further the process of creating a free-trade zone at the hemispheric level, a long-time project in any case, it would be helpful to coordinate positions and criteria among the countries of the region. Among others, the following aspects would have to be spelled out: the harmonization of potential agreements with the United States with regard to commitments to intraregional integration; the setting of an agenda for future negotiations; the taking of a decision about negotiating individually or collectively; and the examination of the advantages and disadvantages of negotiating separate and additional agreements or, instead, of becoming members, through an accession clause, of an eventual North American free-trade agreement.

It would be wise, however, while at the same time pursuing multilateral, hemispheric and regional efforts, to avoid allowing the potential American economic space become a network of free-trade agreements between the United States and each country or group of countries in Latin America. Liberalization should extend to the mutual relations between the countries of Latin America, so that a genuine free trade zone is created at the hemispheric level. To achieve this, decisive progress must be made to integrate Latin America, which among other things requires, as a prerequisite that efforts to stabilize national economies be successful.

c. *The Pacific Rim.* Europe is the only formally constituted economic bloc in existence

thus far, although such a bloc is beginning to take shape in America. The situation is different in Asia. Efforts to create an economic group have been made by some countries belonging to the Association of South-East Asian Nations (ASEAN);¹⁰ they have proposed the formation of a regional bloc of exclusively Asian nations, as is now being considered in the framework of the East Asian Economic Caucus (formerly the East Asian Economic Grouping). However, unlike what is happening in Europe and America, these efforts have been fruitless, nor has any exclusive economic space been officially established anywhere in the zone, in which Japan's economic weight is predominant. On the other hand, the meeting of Ministers of the Asia-Pacific Economic Cooperation Council (APEC), held in Seoul in November 1991, reaffirmed the desirability of strengthening regional initiatives which further multilateral liberalization of trade and investment—for example, in the framework of GATT. This decision involves countries on both sides of the Pacific Rim, since the members of APEC are Australia, Canada, Japan, New Zealand, South Korea, United States, the six countries of ASEAN and three new members: China, Hong Kong and the Chinese province of Taiwan. Pacific Rim countries in the Orient are potential allies of Latin America and the Caribbean for moving towards an economic system in which multilateral rules predominate.

d. *Latin American and Caribbean integration.*¹¹ Over the last two years, the countries of Latin America and the Caribbean have redoubled their internal integration efforts. This process, besides being facilitated by a greater political affinity among democratically elected governments, is being encouraged by new policies aimed at uniform trade liberalization throughout the continent and by a greater consensus concerning these policies. That also explains the characteristics of new commitments to integration. These are no longer seen as a way to substitute for imports at the supranational level, but rather as a means to enhance competitiveness with a view to increase exports and interact under favourable conditions, with the international economy. This is the

reason for the similarity of objectives and goals of the new integration initiatives, which in general are intended to set up common markets or free-trade zones within unusually short periods of time.

Achieving a common market by 1995 is the objective of MERCOSUR, created by the Treaty of Asunción, which was signed by Argentina, Brazil, Paraguay and Uruguay in March 1991, and of the Andean Group, as called for by the Act of La Paz signed in November 1990. Also, a decision was taken in August 1990 to set up a common market in CARICOM, and the Central American Common Market (CACM), in turn, is preparing to create an economic community among its members pursuant to the Central American Plan for Economic Action. In January 1991, Mexico signed an agreement with the countries of CACM to create a free trade zone. This is also the objective of the so-called Group of Three, formed by Colombia, Mexico and Venezuela. Besides these subregional initiatives, there are a number of existing bilateral agreements to eliminate trade barriers between Latin American countries.¹² One of the greatest challenges for Latin America and the Caribbean is to coordinate all these agreements, in order to prevent them from disrupting trade or distorting the competitive advantages of the countries of the region.

The next challenge will be to widen the network of bilateral and subregional agreements so that by the end of the decade there be only one free trade zone—or one extended economic space—in Latin America and the Caribbean, which could be integrated with the countries of North America. In this regard, the presidents of the 13 Latin American countries that make up the Group of Rio expressed in December 1991 their desire to continue to support current processes of subregional integration, so that by the year 2000 the American hemisphere can become a single free-trade zone.¹³

iii) *Regionalism and multilateralism*

There is a risk that the increased trade and integration between regional spaces may take

place mostly between the leading countries of each of these areas (EEC, United States, Japan), with the other countries being linked primarily to the predominant country of their particular zone. For the majority of the countries of Latin America and the Caribbean, this would mean more interaction with the United States.¹⁴ Therefore, the challenge to the region is to avoid any possible tendency towards a relationship excessively concentrated in only one market. This is not to say that the possibilities offered by the Enterprise for the Americas Initiative should be underrated, but only that it should not be the only option. It is a question of keeping the spirit of multilateralism alive. To this end, the countries of the region should persist in their efforts to achieve open trade worldwide, see to it that the creation of a possible free trade zone with the United States does not imply an increase of protectionism *vis-à-vis* third countries and develop economic relations with other regions, especially East Asia and Europe.

b) *The international context and resources for development*

Changing existing production patterns with social equity requires a substantial increase in the rate of investment, which in turn presupposes a concomitant increase in sources of financing, that is to say, a large increase in savings, either external or domestic. Conditions in the international environment influence both, and the present situation has a particular connotation that distinguishes it from the last decade.

First, recent events indicate that there will be more competition for external resources. It is estimated that the unification of Germany, the financing of the transition in Eastern Europe and reconstruction programmes in the Middle East will entail a greater demand for external saving, which in turn will tend to once again raise interest rates in international financial markets.¹⁵ This gives rise, consequently, to the need to raise the rate of saving throughout the world, especially in Latin America, where in

view of the probable increase of competition for external resources and their higher cost, it would be advisable to intensify the efforts already being made to increase domestic saving and improve the productivity of capital.

On the other hand, however, certain characteristics of the international environment favour an increase of external and domestic saving in Latin America. During the 1980s, the heavy burden of the external debt prevented a high percentage of domestic saving from being used for investment. Some progress has been made over the last few years in reducing the debt burden, and this reduction, together with the growing integration of international capital markets, has opened up new possibilities for obtaining financial resources in those markets. Both circumstances have made it possible to reduce the net outward transfer of resources which represented 20% of the total value of exports of goods and services in 1989, to 13% in 1990, the lowest level recorded since the beginning of the debt crisis in 1982. In 1991, thanks also to the sharp reduction of interest rates in the United States, the net transfer was positive for the first time in a decade.¹⁶ Moreover, the new climate of *détente* between East and West will probably lead to an increase of public domestic saving by reducing military spending.

i) *International initiatives to solve the debt problem*

After a long delay in recognizing the seriousness of the developing countries' external debt problem and the need to reduce that debt considerably, creditor countries began to show more flexibility towards the end of the 1980s.

One sign of this greater flexibility was the signing of several agreements to reduce the debt to commercial banks within the framework of the Brady Plan, which was put forward at the beginning of 1989. Four countries (Costa Rica, Mexico, Uruguay and Venezuela) have signed agreements of this nature, so far and other large debtors, such as Argentina and Brazil, are

expected to do the same. According to the International Monetary Fund, the net effective debt reduction obtained by these four countries was US\$11 billion, or 15% of the total value of their obligations before the programmes were put into effect.¹⁷ There has also been a non-official accumulation of arrears in debt service, which has provided a temporary escape valve in the face of debt overhang and the slow progress of negotiations to reduce the debt.

Official bilateral debt has also been reduced, following different criteria depending on the income level of the debtor country. After adopting the Toronto Terms in 1988 to grant special terms to low-income debtors, the creditor governments of the Paris Club agreed on the Houston Terms in 1990, offering new payment facilities to low-income countries, including the swapping of debt for local currency. The Toronto Terms were applied in 1990 to Bolivia and Guyana, and the Houston Terms to El Salvador, Honduras, Jamaica, Peru and the Dominican Republic. The reduction by at least 50% of the bilateral official obligations of Poland and Egypt also constituted a precedent of debt forgiveness in middle-income countries.

Finally, mechanisms have been proposed within the framework of the Enterprise for the Americas Initiative to reduce the region's debt with the United States by US\$12 billion. By the end of September 1991, the United States had cancelled a total of US\$1.5 billion to seven countries in the region. Since most of them were countries with relatively small economies, the reductions were quite significant: in the cases of Honduras, Nicaragua and Guyana, 90% of what was owed was cancelled, as was 70% of the debt of Bolivia and Haiti.

With respect to debt owed to multilateral bodies, the so-called accumulation of drawing rights approach, introduced in 1990 to adjust the position of countries in a situation of prolonged moratorium with the International Monetary Fund, is worthy of note. Through this system, the debtor country accumulates refinancing rights as it meets the goals of an adjustment programme. Once the programme has been successfully completed, the country pays its

arrears to the Fund by organizing a transition loan from a group of "support" governments, and then converts the accumulated rights into a disbursement of the Fund's resources as part of a normal IMF programme. This scheme is being used in Latin America as the basis for normalizing Peru's situation with its external creditors.

As a result of these measures and also of the significant reduction of bank debt achieved through various national mechanisms (especially important in the case of Chile), the external debt question has lost relevance in some countries of Latin America over the last few years. However, several of them are still experiencing debt overhang and the structural consequences continue to curtail the degree of freedom of their economic policies and their growth possibilities.¹⁸ It is essential for these countries to reduce a large percentage of their debt if they are genuinely interested in making significant progress in social equity.

Although debt reduction has become increasingly acceptable as an integral part of a structural adjustment programme, the amounts being considered in the context of the Brady Plan and the Paris Club are still too small. First, the official financial resources available for financing the buyback of bank debt, or for converting it into bonds, are normally inadequate. Second, effective debt reduction means applying more coherent and sustained institutional pressure on creditors. There is certain reciprocity between these two variables: the more voluntary the process, the greater the financing needed to achieve a certain amount of reduction of the debt, and vice versa.

The international strategy for dealing with the problem seems to have reached a crossroads at this time, which suggests the need to take some new steps forward. The limited amount of official financing available to support debt reduction programmes would seem to point to a need to look for "less voluntary" mechanisms, which would avoid upward pressures in the secondary market during the process of voluntarily reducing the debt. A scheme which sets stricter limits on the participants' margin of

freedom also allows for reducing the debt on the basis of a more realistic estimation of the debtor country's ability to pay over the medium term, and for ensuring that all banks participate in the reduction.¹⁹ This scheme, although it is not strictly voluntary, simply reproduces a rather common procedure used in the financial markets of the industrialized countries when creditors are confronted with a debtor who should not or cannot go bankrupt.

With respect to bilateral debt with the Paris Club, an especially important question for the small countries of the region, progress would be made if other creditor governments followed the example of the Enterprise for the Americas Initiative and considered cancelling at least 50% of the outstanding obligations of countries suffering from debt overhang.

Finally, for a certain number of countries, again primarily the small ones, multilateral debt represents a third or more of their total public debt (see table II-2). At present, these obligations cannot be reprogrammed and official schemes for debt relief, such as the "support groups" and the "rights approach" of the IMF, only come into play after a country has fallen into a serious arrears situation. Given the recent spate of such cases, it would undoubtedly be wise to introduce new concessionary refinancing mechanisms, in order to deal with excessively burdensome problems of multilateral debt with anticipation.

ii) *International capital markets*

Over the last few years, international capital markets have been characterized by a growing integration between countries, market segments and financial institutions instruments. This integration has produced positive results, in so far as it has led to more competition between financial institutions and a more efficient process of intermediation at the world level. However, it has also heightened the price instability of financial assets and posed serious problems for the supervision of banking and the management of monetary and exchange policy.

The volume of resources being handled in the world financial market is already enormous. For example, the value of loans contracted in international capital markets doubled between 1982 and 1990, reaching US\$423 billion in 1990.²⁰ All indications are moreover, that the integration process will consolidate even further in the future. These two circumstances represent important opportunities and challenges for the Latin American countries, since the ever more global perspective of institutional investors and their interest in diversifying their asset portfolios by investing in high-yield instruments provide a potentially large supply of resources.

Some countries have recently been able to take advantage of the positive trends in credit markets to renew voluntary borrowing. This new access to voluntary financing takes the form of international bond issues and foreign investment in stocks.

The reopening of the international bond market to Latin American borrowers began in the 1987-1989 period, but it accelerated notably during 1990 and 1991, although it remained concentrated in a limited number of countries (Argentina, Brazil, Mexico and Venezuela). The cost of this kind of financing has been relatively high, although there is a clear trend towards lowering the risk premium on Mexican and Venezuelan bonds. Another characteristic of this kind of financing is that until now the terms have been relatively short; maturity dates have generally fluctuated between two and five years. Therefore, it will be necessary in the future to maintain a continuous flow of new loans to prevent the net transfers related to this form of financing from becoming negative over a short period of time.

The other channel that has provided private resources from the international capital market is foreign investment in shares of stock. The amount of external resources recently as invested in some Latin American countries, such as Mexico and Chile, is considerable. For example, Mexico's balance-of-payment figures show that income representing foreign investment in shares of stock, which stood at US\$490 million in

Table II-2
LATIN AMERICA: EXTERNAL DEBT RATIOS, 1980-1989
(Percentages)

	Public external debt/ Total external debt			Multilateral external debt/ Public external debt			Bilateral external debt/ Public external debt			External debt with commercial banks/ Public external debt			Other external debt/ Public external debt		
	1980- 1981	1986- 1987	1988- 1989	1980- 1981	1986- 1987	1988- 1989	1980- 1981	1986- 1987	1988- 1989	1980- 1981	1986- 1987	1988- 1989	1980- 1981	1986- 1987	1988- 1989
Latin America and the Caribbean	51.6	76.2	77.2	10.7	13.9	15.3	12.0	12.7	14.7	61.1	60.9	56.7	16.3	12.6	13.3
Petroleum-exporting countries	52.7	75.7	77.6	9.8	13.3	15.3	11.1	10.3	11.8	65.8	65.8	60.5	13.3	10.6	12.5
Bolivia	82.9	76.2	81.9	19.7	23.5	33.1	30.7	48.1	52.1	33.1	21.0	11.8	16.5	7.3	2.9
Colombia	58.5	80.4	82.2	32.1	39.7	40.4	22.7	18.5	17.6	37.9	31.8	30.2	7.3	10.0	11.8
Ecuador	57.0	87.1	83.7	9.8	18.9	21.2	31.7	13.6	17.7	50.3	60.9	52.5	8.2	6.6	8.7
Mexico	56.7	76.1	79.8	8.9	11.6	13.4	3.9	5.8	7.5	75.4	72.2	66.7	11.8	10.4	12.3
Peru	60.3	69.2	64.8	9.5	15.8	16.2	40.8	34.6	36.2	26.7	32.5	31.1	23.1	17.0	16.5
Venezuela	36.0	72.2	73.8	1.8	0.5	1.7	3.3	1.0	1.2	78.1	87.9	83.0	16.9	10.5	14.1
Non-petroleum-exporting countries	50.5	76.6	76.8	11.5	14.3	15.4	12.8	14.7	17.1	56.6	56.9	53.6	19.1	14.3	13.9
Argentina	33.0	81.3	80.1	11.2	7.4	8.5	7.2	9.0	10.4	60.4	57.3	55.8	21.2	26.3	25.3
Brazil	56.9	74.4	76.2	7.6	12.7	12.9	9.5	13.2	15.1	62.0	62.1	60.7	20.9	12.0	11.3
Costa Rica	64.5	78.7	77.9	23.6	27.3	28.8	19.4	25.5	27.8	39.1	41.4	41.0	17.9	5.8	2.4
Chile	33.1	70.9	64.9	8.2	18.2	28.3	20.6	4.4	8.7	55.3	72.3	57.3	15.9	5.1	5.7
El Salvador	58.9	87.7	89.5	48.5	46.3	46.6	49.6	47.5	49.4	1.6	6.0	4.1	0.3	0.3	0.0
Guatemala	55.8	82.7	80.5	57.7	37.5	43.1	36.1	31.3	36.3	6.0	8.8	8.2	0.2	22.4	12.4
Haiti	80.4	80.3	84.4	50.3	61.1	64.3	31.2	28.6	28.1	2.4	7.5	6.8	16.1	2.8	0.9
Honduras	69.8	80.9	83.8	44.6	50.1	50.9	25.9	29.7	32.3	21.9	14.6	11.3	7.5	5.6	5.4
Nicaragua	78.8	84.3	82.8	26.0	14.5	13.0	31.3	62.1	68.4	41.9	22.7	18.1	0.8	0.7	0.6
Panama	74.1	71.0	63.1	14.6	27.8	27.5	13.3	10.4	10.6	50.3	53.5	53.9	21.9	8.3	8.1
Paraguay	63.7	87.9	84.1	33.2	37.0	36.0	31.4	26.7	32.3	16.6	25.6	21.5	18.7	10.7	10.3
Dominican Republic	61.0	80.7	81.3	18.3	23.1	23.4	50.9	48.8	48.7	29.3	25.0	22.9	1.5	3.1	4.9
Uruguay	64.6	73.3	78.1	14.6	15.7	20.1	12.0	3.4	3.0	49.9	65.8	58.4	23.5	15.1	18.5

Source: ECLAC, based on figures from *World Debt Tables*, World Bank.

1989, reached US\$2 billion in 1990 and more than US\$6 billion during the first half of 1991.

New flows of private capital thus loosened the constraints on external financing in Latin America and the Caribbean during the past decade. However, there is still a doubt about how durable these flows are as a basis for development, and especially about the possibility of other countries in the region entering the market. The unstable and procyclical nature of international movements of private capital, involving risks and costly access to this kind of financing, should be kept in mind.

The use of the various financial instruments should therefore be systematically evaluated and then compared with other possible sources of external financing, such as bilateral and multilateral loans and foreign direct investment. Care should also be taken to ensure that incoming private capital does not repeat the excesses of the 1970s, when an unrestricted openness to external private financing—at the time from commercial banks—led to the debt overhang situation. Consideration should be given to the possibility of creating financial instruments to be issued by countries of the region, with a yield that would vary in relation to the prices of their main export commodities, to help compensate for fluctuations in their export earnings. These and other financial instruments issued by the region could be partially backed by the multilateral agencies, in order to help provide additional countries with access to the international capital market.

iii) *Disarmament and resources for development*

Military expenditures throughout the world have been estimated at US\$1 trillion a year, 20% of which is spent by developing countries. This figure should be compared with the US\$1.3 trillion owed by developing countries. Reducing military expenditures would allow for increased global saving to meet new investment needs, and even help to balance the budgets of the leading developed economies, with positive effects on

real interest rates and on the world economy. Moreover, if some of these resources were dedicated to development activities, the developing countries would benefit directly. Also, Latin America and the Caribbean now have the opportunity to increase domestic public saving and investment in development by reducing their own military budgets.

The reduction of military expenditures in a number of countries would also be promoted and facilitated by reinforcing the United Nations' role in conflict settlement and prevention, and would be encouraged by the favourable international climate with regard to such a reduction. The United Nations is now in a better position to help ensure the territorial integrity of countries, and governments could thus reduce their military budgets with more confidence.

c) *Trends shaping the world economy*

The present economic situation reveals certain elements of the world economy's vulnerability and the risks it poses to a future strategy for changing existing production patterns with social equity. It is increasingly necessary for public policies to be coordinated and harmonized; the existence of a multipolar order makes this task more difficult, however. Economic policy decisions are becoming more decentralized, but countries are becoming increasingly interdependent. Great effort was extended during the 1980s to coordinate the monetary and fiscal policies of the major industrialized countries belonging to the Group of Seven. That coordination was needed in order to deal with the integration of financial markets and to attempt to limit the severe balance-of-payments deficits produced by massive capital movements arising from changes in interest and exchange rates.²¹ The Plaza Agreement of 1985 and the Louvre Agreement of 1987 are examples of such coordination. However, such concerted efforts have been less successful in recent years, as can be seen in the experience of the decline of the dollar, virtually abandoned to market forces in 1990.

At the same time, the outlook for economic growth in a multipolar and globalized world, in which technical progress plays a crucial role, has become more dependent on the expansion of international trade. For a long time, trade grew more quickly than world output (except in 1985), and it has doubled since 1988. Multilateral efforts to liberalize trade and make its rules more uniform, both in the Uruguay Round and in the framework of regional groupings, have therefore, become extremely important.

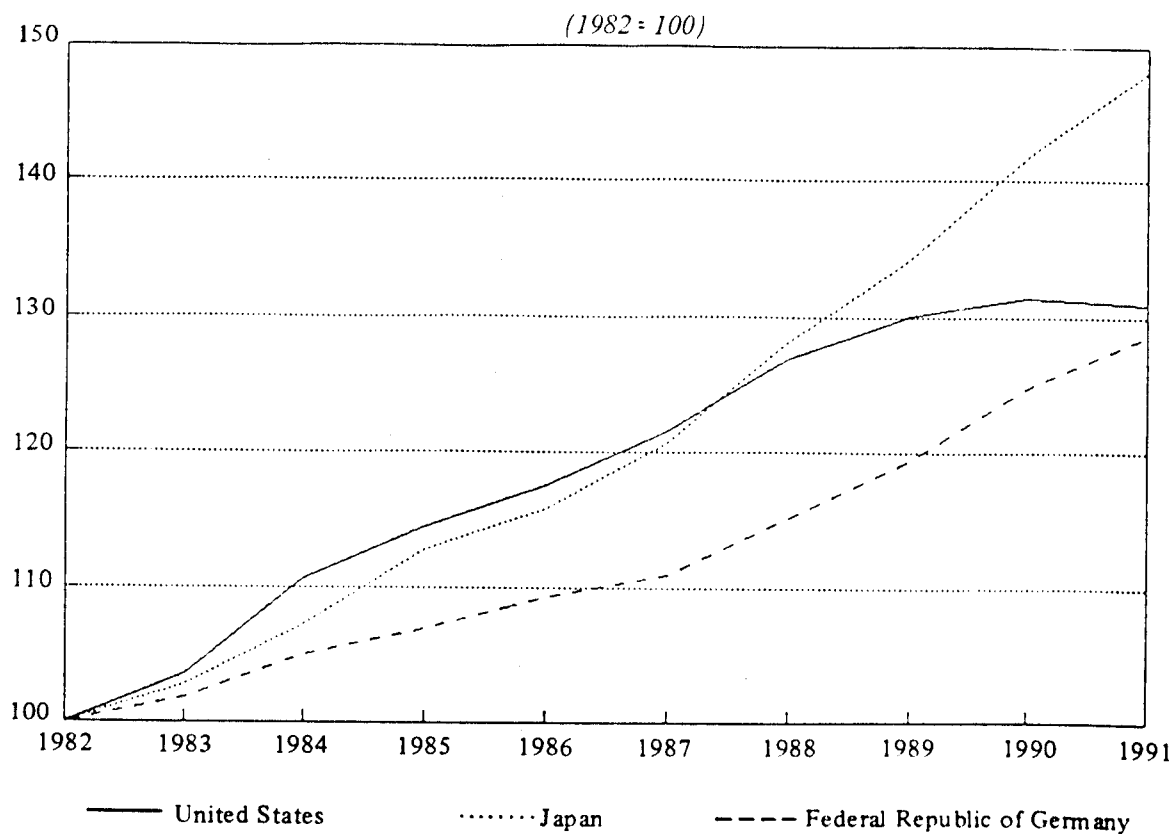
If the conditions for greater coordination and harmonization are met and multilateral efforts to liberalize trade are successful, forecasts for a reasonable medium-term growth

of the world economy, which the International Monetary Fund predicts will average more than 3% a year between 1993 and 1996 could become a reality. The new world order would thus be in a position to contribute to a relatively favourable international environment for the domestic development efforts of the Latin American countries.

Conditions have not been so favourable in recent years. In 1990, the growth rate of the United States economy began to drop appreciably. That led to a drop in that country's output in 1990 and the beginning of 1991, a situation which also affected the other English-speaking countries (Australia, Canada, New Zealand and the United Kingdom), thus bringing

Figure II-1

UNITED STATES, JAPAN AND THE FEDERAL REPUBLIC OF GERMANY:
INDEX OF GROSS DOMESTIC PRODUCT



Source: International Monetary Fund.

to an end the long period of growth experienced by both the United States and the world economy, which began with the end of the 1982 recession and lasted through the rest of the 1980s.

In view of the constraints on United States monetary policy stemming from the need to finance the current-account balance beyond the short term, the evolution of that country's economy has become more dependent on externalities, particularly the policies adopted by the other economic centres. The variable that typifies this condition is the interest rate: the increasing difficulty of keeping interest rates in line constitutes a disturbing element.

As seen in figure II-1, the United States economy recorded solid growth, above that of the other two countries, following the crisis of 1982. The favourable picture began to fade, however, and by 1988 growth had fallen below that of Japan. In 1990, divergent growth occurred for the first time. While the United States economy entered a recession, the economies of Germany and Japan continued to expand, so much so that the United States economy now appears to be on the verge of also falling below that of Germany. Consequently, the present scenario is asynchronous: the recession in the United States, with a growth rate of only 1% in 1990 and estimated at -0.3% for 1991, stands in contrast to that of the economies of Germany (4.5% in 1990) and Japan (5.6% in 1990). These last two economies, in turn, will probably enter a phase of slower expansion in the 1991-1992 period, while the United States economy could begin a partial recovery in 1992.²²

Notes

¹ ECLAC, *Changing Production Patterns with Social Equity...*, *op. cit.*

² See, among others, United Nations Conference on Trade and Development (UNCTAD), *Accelerating the Development Process. Challenge for national and international policies in the 1990s: Report by the Secretary-General of UNCTAD to*

UNCTAD VIII (TD/354), Geneva, 9 August 1991; United Nations Conference on Trade and Development (UNCTAD), *Trade and Development Report 1991* (TDR/11), New York, 1991; ECLAC, *La economía de la Unión Soviética en la perestroika y las reformas políticas y económicas* (LC/L.638), Santiago, Chile, 15 July 1991; and, ECLAC, *Internacionalización y regionalización de la economía mundial: sus consecuencias para América Latina* (LC/L.644), Santiago, Chile, 23 September 1991.

³ ECLAC, *The International Common-Carrier Transportation Industry and the Competitiveness of the Foreign Trade of the Countries of Latin America and the Caribbean*, Cuadernos de la CEPAL series, No. 64 (LC/G.1575-P), Santiago, Chile, November 1989. United Nations publication, Sales No. E.89.II.G.14.

⁴ See United Nations General Assembly resolutions 3201(S-VI) and 3202(S-VI) and resolution 3281(XXIX).

⁵ Robert Z. Lawrence, "Developing Countries and Global Trading Arrangements", Washington, D.C., The Brookings Institution, 1991, unpublished.

⁶ Trade between Asia and Western Europe and between Asia and North America during the 1980-1989 period grew more than intraregional trade in Western Europe and North America. See General Agreement of Tariffs and Trade (GATT), *International Trade*, 1989/90, vol. II, Geneva, 1990.

⁷ For a discussion of this issue from the region's perspective, see, ECLAC, *Europa 1992 y sus consecuencias económicas sobre América Latina* (LC/R.918(Sem.59/3)), Santiago, Chile, 13 September 1990.

⁸ See Thomas J. Duesterberg, "Prepare now for the 1992 export market", *Business America*, 25 February 1991.

⁹ See the text of the address by the President of the United States, George Bush, given in Washington, D.C., on 27 June 1990, as well as the intervention of Myles Frechette, Assistant United States Trade Representative for Latin America, the Caribbean and Africa, in the seminar on *The United States and Argentina in Relation to the Enterprise for the Americas Initiative*, The American University, 12 June 1991.

¹⁰ ASEAN includes Brunei Darussalam, the Philippines, Indonesia, Malaysia, Singapore and Thailand.

¹¹ This topic is treated more fully in another document presently being prepared by the secretariat.

¹² See ECLAC, *La integración económica en los años noventa: perspectivas y opciones* (LC/R.1042), 20 August 1991.

¹³ Joint declaration of the Fifth Summit Meeting of the Permanent Mechanism for Consultation and Policy Coordination, held in Cartagena, Colombia, 1-3 December 1991.

¹⁴ This could happen, given the possible characteristics of trade within these spaces and between them. Trade between the "poles" seems to have a high and growing content of horizontal intrasectoral trade that is, trading of different varieties of the same products. Trade in manufactures between each pole and the other countries in its economic space could have a strong component of vertical intrasectoral trade; i.e., exports of parts and components from the former to the latter to be assembled and re-exported to the country of origin. (See ECLAC, *Informe de la reunión de expertos sobre perspectivas de la economía mundial y opciones de América Latina y el Caribe* (LC/R.1065), 24 October 1991, pp. 3 and 4.) The application of strict rules of origin, a delicate point in negotiations on the possible integration of the United States with the EEC, would ensure that this form of trade would only take place within the economic space, excluding parts and components from third countries.

¹⁵ International Monetary Fund (IMF), *World Economic Outlook*, Washington, D.C., October 1991.

¹⁶ ECLAC, *Preliminary Overview of the Economy of Latin America and the Caribbean*, 1991 (LC/G.1696), Santiago, Chile, December 1991.

¹⁷ International Monetary Fund (IMF), *International Capital Markets: Developments and Prospects*, Washington, D.C., May 1991, table 15, p. 76.

¹⁸ A detailed analysis of the systemic nature of the debt crisis appears in ECLAC, *Latin America and the Caribbean: Options to Reduce the Debt Burden* (LC/G.1605-P), chapter 2, Santiago, Chile, 1990, United Nations publication, Sales No. E.90.II.G.7.

¹⁹ As pointed out in ECLAC, *op. cit.*, the estimate of ability to pay should come from an IMF adjustment programme which establishes acceptable, explicit goals for investment and growth. Moreover, reduction agreements could contain contingent clauses that allow for payments to rise or fall if the *ex post* evolution of payment ability differs markedly from the *ex ante* estimated ability.

²⁰ Organization for Economic Cooperation and Development (OECD), *Financial Market Trends*, No. 49, June 1991.

²¹ See Michael C. Webb, "Coordination of macroeconomic adjustment policies", *International Organization*, vol. 45, No. 3, 1991.

²² International Monetary Fund (IMF), *World Economic Outlook*, *op. cit.*, various estimates and projections.

Chapter III

ECONOMIC STABILIZATION

It would be extremely difficult indeed for the countries to change their production patterns with social equity unless basic macroeconomic balances are first maintained within reasonable or tolerable limits. Just how much is "tolerable" may be open to discussion, but it is obviously impossible to embark upon a solid, sustained growth process in the presence of a large current account deficit and inflation of three digits or more. In fact, in the 1980s five countries in the region recorded inflation rates of four or five digits, another two had three-digit inflation, and four other countries saw their annual rates soar above 75%. Restoring and then maintaining basic macroeconomic balances is clearly a necessary step if production patterns are to be changed with social equity in countries that still suffer from such inflationary surges. To accomplish this, priority may be placed on policies that will help to safeguard the existing degree of equity and, at the same time, to lay the foundations for achieving greater equity in the future.

1. The turnaround in the transfer of resources, the fiscal deficit and rising inflation

The region's instability and stagnation during the 1980s was the result of unprecedented macroeconomic imbalances in the external sector, in fiscal accounts and in production. These three imbalances have been closely interrelated, although their relative significance

over time has varied from one country to another.

During an initial phase (1979-1981), unusually large deficits on current account (over 4% of GDP) were recorded, and these deficits were financed by means of an unsustainable rate of external borrowing.

The second phase began with the sudden cut-off of capital inflows in 1982. When this occurred, the region ceased to be a net capital importer—as befits a developing region—and became a net exporter of capital amounting to 4% of its GDP. The suddenness and magnitude of the turnaround made it necessary for the region to carry out a recessionary adjustment in 1982-1983 in order to generate the trade surpluses demanded by the situation. It did so primarily by sharply cutting its imports of consumer items and of the intermediate and capital goods it required in order to maintain and expand its production capacity.

The year 1984 saw the start of a third phase—which is still in progress in a number of countries—marked by large fiscal deficits and, as a consequence, a rapid acceleration of inflation. These inflationary surges—together with the attempts made to stifle them—largely account for the recession and stagnation which have plagued most of the countries in the region during the decade.

Since most of the external debt incurred prior to the crisis was composed of public or government-guaranteed obligations, and since a large portion of the private debt was later assumed by the State, the bulk (about 70%) of

the resources transferred abroad since 1982 have come from the public sector. Thus, the debt problem engendered another transfer-related problem: how to go about making an internal transfer of resources to that sector, which represented a turnaround in public finances equivalent to about 4% of GDP.

Since public-sector income in the countries of the region amounts to between 15% and 30% of GDP, marshalling sufficient domestic resources to sustain an external transfer equivalent to 4% of GDP called for an enormous fiscal adjustment, since it meant that income had to be raised or expenditure had to be cut by 15%-25% in real terms. The speed-up in inflation experienced by the region during the 1980s stems from the fact that, in most of the countries, the public sector was unable to mobilize the whole of this sum without resorting to mechanisms of money creation. The authorities relied on domestic borrowing in only a few cases and, when they did so, they generally found themselves faced with high interest rates, greater pressure on prices, and a deepening recession.

This course of action had particularly dramatic effects in countries with a long history of inflation, where indexation mechanisms and expectations magnified the impact of the public deficit on price trends.

2. The costs of high inflation in terms of production and distribution

Although, theoretically, there is no reason why high inflation should have a major impact in terms of distribution or production—provided that the rate of inflation is stable—in practice high inflation rates usually become increasingly unstable and therefore affect both growth and social equity. Hence, any evaluation of a stabilization programme should compare its costs with the costs of high and unstable inflation rather than with those of a normal economic situation.

The production costs of high, unstable inflation are associated with the increasingly

widespread use of the short term as a decision-making horizon. As uncertainty mounts, the planning horizon, the length of contracts and their time limits all become shorter. For example: i) businessmen increase their markups in response to the unstable economic environment and the possibility of sustaining heavy losses if they misjudge future inflation; ii) the maturities of financial offerings are shortened—sometimes to no more than a few weeks—which increases the risk involved in financing slow-yielding projects; iii) in the same way as it hurts financial markets, price instability may also be associated with a lack of interest in investing. Uncertainty as to project rates of return acts as a disincentive for increases in production capacity, and this is often coupled with a strong tendency to take refuge in certain types of existing assets and in capital flight; iv) it sometimes proves to be the case that in unstable economies the production elasticity of employment is not very great; this unresponsiveness to fluctuations in output is yet another manifestation of the reluctance to take decisions whose reversal would be costly; v) as a partial alternative to the reduction of time horizons, the use of indexation mechanisms often becomes widespread. Nonetheless, although the use of readjustable contracts and arrangements does represent an adaptation to price instability which facilitates some types of operations, it is no substitute for stability; vi) the lack of a reliable unit of account prevents the government's budget from being used to guide the management of fiscal affairs; vii) finally, the use of shorter-term horizons leads decision makers to underestimate the deterioration of natural capital, which jeopardizes the sustainability of development.

Nor is high inflation neutral in terms of distribution—no matter how well economic agents may have adapted to the situation—because the flexibility, speed and nature of their adaptive mechanisms will not be the same for all agents or all types of transactions. Thus, for example: i) wage payment periods often change more slowly than the rate of inflation; in other words, exchanges involving low-income sectors

are carried out on the basis of a "payments technology" that is not geared to the pace of change associated with high inflation rates; ii) it is unlikely that wage earners will be able to escape the effects of inflation by depositing their wages in interest-bearing accounts or by converting them into dollars. The practice of substituting foreign exchange for local currency as a medium of payment is used in operations involving large sums of money (e.g., the sale of real estate) but not in everyday transactions, and this protective mechanism is therefore unavailable to a large percentage of the population. Wage earners are most likely to respond by making their purchases immediately after being paid, but even so they must keep a portion of their income in a liquid form. In such cases, the inflation tax will have a proportionally greater impact on low-income sectors and therefore takes on a regressive character; iii) an additional factor is the loss of wages, in real terms, that occurs each time the rate of inflation climbs; this lost income is not usually recovered through subsequent wage adjustments, even if they are made more frequently.

Hyperinflation adds further to the production and distributive costs associated with ordinary processes of high inflation. The environment becomes so complex that, on the one hand, any economic activity whatsoever takes on a "speculative" character while, on the other, agents seek —if at all possible— to keep their exposure to the vagaries of the local economy to an absolute minimum. Strong incentives for capital flight make their appearance and transaction costs skyrocket; in consequence, production and the demand for labour often fall, and these factors add their effects to the already high distributive costs of high inflation.

Regardless of the tax system's degree of indexation, a steep decrease is usually seen in tax receipts (e.g., Bolivia in 1985 and Peru in 1989). This severely narrows the range of policy options and, in extreme cases, can

render the government incapable of action. One of the reasons for this is undoubtedly the effect of tax collection lags, but the disorganization of the public sector and the drop in the level of economic activity which usually accompany such inflationary spirals are also factors.

Furthermore, because these economies are highly indexed (since, unlike the cases of hyperinflation seen in Europe, the outbreak of the hyperinflationary processes experienced in Latin America and the Caribbean followed on the heels of a long period of high inflation), the public debt is not "diluted" by the acceleration of inflation and may, in fact, even increase. This is because the assumption of debt for very short terms minimizes the impact of "inflationary surprises", but it also raises the real interest rate that must be paid in order to refinance it.

Finally, whereas it is usual to refer, whether explicitly or implicitly, to past inflation in situations of high inflation, in hyperinflationary contexts the price variations of the month before provide no information about the following month's price trends. In other words, rapid rates of price increases and price instability within the framework of very short time spans causes indexation mechanisms to break down. Consequently, wage determination is necessarily carried out "in advance", and wages will therefore be readjusted more frequently or may even become partially dollarized. This adds more fuel to the inflationary spiral as well as heightening workers' uncertainty as to the real value of their wages and businesses' uncertainty as to their wage bills.

Thus, experience has demonstrated that high inflation has high costs in terms of both output and social equity. These costs have to be eliminated, or at least minimized, not only once inflation has been brought under control, but also while anti-inflationary efforts are in progress so as to pave the way for a subsequent recovery.

Box III-1

THE COSTS OF INFLATION AND THE RISK OF A STABILIZATION-INDUCED RECESSION

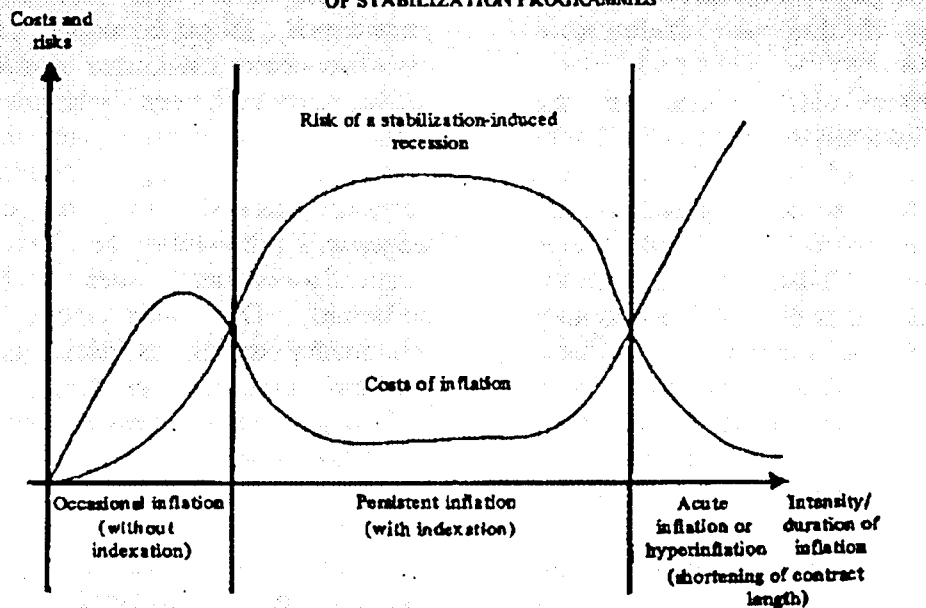
Both the costs of inflation and the risk of a stabilization-induced recession will vary depending on whether inflation is an occasional phenomenon, a persistent problem or an acute process that is heading towards hyperinflation.

The costs of inflation tend to spiral. They will be proportional to the rate of inflation so long as it is unexpected, but when inflation becomes a persistent phenomenon, inflationary expectations give rise to indexation mechanisms which largely put an end to the erosion of wages, the balance-of-payments deficit and the slump in saving usually associated with occasional bouts of inflation. Consequently, persistently high inflation, even when it nears the three-digit level, can be compatible with a satisfactory growth rate and thus, in one sense, be tolerable provided that it is relatively stable. The costs become intolerable, however, in the case of acute inflation which is verging on hyperinflation because then the terms of contracts and, hence, the planning horizon are shortened, thereby making economic calculations immeasurably more difficult.

The risk of recession associated with an anti-inflationary programme, for its part, can be represented by an upside-down "U". When inflationary expectations are absent (in cases of occasional inflation) or relatively unclear (in cases of hyperinflation), the risk of a recession is fairly small. In addition, the stabilization of a hyperinflationary situation is facilitated by the fact that since all prices are adjusted daily, their adjustment tends to be based on the only important parameter of costs which also changes daily and whose price is known to all: the open-market exchange rate. Thus, all prices can be aligned quickly in a synchronized manner simply by stabilizing the exchange rate.

This is why the least recessionary stabilization processes in the region (Costa Rica in 1982 and Bolivia in 1985) as well as those stabilization efforts which have been coupled with economic growth (e.g., Argentina during the second half of 1990) have for the most part taken place in situations marked by one or the other of these types of inflation. In contexts of persistent inflation, on the other hand, the very expectations and indexation mechanisms which make this type of inflation tolerable also make prices unresponsive to a downturn in aggregate demand, and the risk of recession is therefore high (as is illustrated, for example, by the recessionary stabilization efforts of Argentina and Chile in the mid-1970s).

RELATIVE COSTS OF INFLATION AND RISKS
OF STABILIZATION PROGRAMMES



Source: René Cortázar, "Políticas macroeconómicas y concertación", *Inflación reciente en América Latina*, José Pablo Arellano (comp.), Santiago, Chile, Economic Research Corporation for Latin America (CIEPLAN), Hachette, January 1990.

Table III-1

**LATIN AMERICA AND THE CARIBBEAN: INFLATION AND
GROWTH IN SELECTED COUNTRIES**

(Average for 1980-1990)^a

Country	Average inflation	GDP growth rate
Nicaragua ^b	4 670	-0.8
Peru	1 175	-0.2
Bolivia	1 014	-0.2
Argentina	804	-0.7
Brazil	530	2.3
Mexico	66	2.3
Uruguay	65	1.0
Ecuador	37	2.4
Dominican Republic	29	2.3
Costa Rica	27	2.3
Venezuela	25	0.5
Colombia	24	3.4
Paraguay	22	3.9
Chile	21	3.3
El Salvador ^b	19	-0.7
Guatemala	18	1.0
Honduras	9	1.8
Haiti	9	0.5
Panama ^c	3	4.4

Source: International Monetary Fund (IMF), International Financial Statistics (various issues); figures provided by the countries; and Economic Commission for Latin America and the Caribbean (ECLAC), Statistical Yearbook for Latin America and the Caribbean, 1990 Edition (LC/G.1651-P), Santiago, Chile, 1991. United Nations publication, Sales No. E/S.91.II.G.I.

^a The figures used for 1990 are preliminary.

^b The figures for Nicaragua and El Salvador have been affected by the civil wars which were fought in these two countries during the 1980s.

^c Data for 1988 and 1989 were not taken into account because they were distorted by the embargo imposed by the United States.

3. The lessons of the 1980s and their implications for changing production patterns with social equity

One of the first lessons to be drawn from the region's experience during the 1980s is that, in practice, it is impossible for a country to grow on a solid, sustained basis unless macroeconomic imbalances are held within tolerable limits. Although all the countries of the region were affected by the crisis, the subsequent growth of those countries in which inflation was more moderate or less variable was impaired less than in the others. This rather select group includes not only Chile, Colombia and Paraguay—all relatively low-inflation countries—but also countries such as Costa Rica, which managed to bring inflationary surges rapidly under control, and the Dominican Republic and Ecuador, where fluctuations were smaller.

Of course, the maintenance of basic macroeconomic balances is not enough in itself to bring about growth (the reader might consider, for example, Haiti's stagnation despite its low rate of inflation or the slowness of Bolivia's growth following its stabilization); it is, however, one prerequisite. Prudence, in this regard, is nothing more than a recognition of the fact that an economy's production capacity and supply of foreign exchange set very real limits on macroeconomic policy management.

Not only were the countries' macroeconomic imbalances costly, but their attempts to restore those balances proved to be so as well. Although it is theoretically possible to design non-recessionary stabilization and adjustment programmes, in practice such programmes do have contractive effects. Moreover, when one stabilization plan ends in failure, the costs of the next one tend to be even greater, as is suggested by the results of the stabilization attempts made by Argentina, Brazil and Peru following the failure of the Austral, Cruzado and Inti plans, respectively.

The confidence and credibility required in order for a country to resume its growth on a solid basis are not regained immediately upon the restoration of basic macroeconomic balances;

these balances must first be consolidated. This is demonstrated, for example, by the experiences of Bolivia after 1985 and of Mexico after 1987.

For many countries of the region, their immediate recovery, as well as their sustained growth thereafter, is contingent upon the control of inflation and the subsequent consolidation of that control. Once a stabilization effort has been successfully completed, a country can then begin its recovery and embark upon the process of changing its production patterns.

Stabilization programmes have failed for one of two reasons: either they have proved to be contractive or they have not managed to lower inflation on a lasting basis. Both experience and theory tell us that unless aggregate demand is controlled and the fiscal deficit is "adjusted", no stabilization programme can bring down inflation once and for all. Experience also suggests, however, that balancing a country's fiscal accounts is usually not enough in itself to reduce inflation rapidly at a minimum cost in terms of recessionary effects.

Although in theory there is no inescapable reason why the reduction of inflation need be directly linked to decreases in production or why there should be a positive correlation between the initial level of inflation and the severity of the subsequent recession, the fact of the matter is that, all too often, stabilization programmes end up causing recessions. If we exclude cases in which stabilization plans have been implemented in hyperinflationary contexts, we find that there have been very few cases of non-recessionary stabilization processes.¹ In the former, a reactivation is often achieved when supply distortions are diluted and credit become available once again simply because inflation has slackened. The chief objective, then, of any stabilization programme should be to lower inflation without causing production to fall, or at least to minimize a recession if it does occur.

The social and distributive costs of a stabilization programme are directly related to the unemployment or recession that it produces. Recessions often hurt workers in two ways: directly, in the form of lower employment;

and indirectly, through the decline in wages to which high unemployment soon leads. Therefore, the smaller the impact on production, the smaller the impact on employment and, hence, on income levels and distribution. In any event, in order to be accurate the evaluation of a stabilization programme's social and economic impacts should not be based on a comparison with the non-existent costs of a theoretically perfect programme, but rather on a comparison with the economic, social and distributive costs of persistently high inflation, which may be very great indeed. The latter is the true point of reference. In sum, a non-recessionary stabilization process is efficient and desirable from both a social and an economic standpoint because it puts an end to the regressive costs of high inflation and sets the stage for a transformation of production patterns.

If a recession does occur, one option is to place priority on short-term measures for reducing the number of working hours or days in the workplace—at least for the primary workforce—since this will distribute the cost among a larger number of workers, lessen the decrease in wages and keep most people working in their usual activities. This option can be supplemented by the creation of emergency employment programmes as a temporary source of income for the neediest families.

Since all inflationary processes (especially when they involve notably high rates) are generally coupled with an expansion of the money supply (whether it be exogenous or endogenous), one prerequisite for a reduction of inflation is, as a rule, to control aggregate demand, the growth of the money supply and the public deficit which is its source. In effect, whatever its origins, inflation is a "tax" on money balances which is collected by the Treasury or issuing agent in order to "finance" its deficit, which it has covered by means of currency issues. In order to lower that tax, the fiscal deficit must be reduced. It is not necessary to increase the effective transfer of resources from the private sector to the Treasury; instead, it is a matter of replacing the "inflation tax" with an explicit increase in revenues, which could be

accomplished either by raising the rates charged for public services or by raising taxes. Nor is it necessary to make structured changes in the real sector (production and employment); all that is called for is to slow down, as evenly as possible, the growth rates of the *nominal* values of the main economic variables (prices, wages, interest rates, exchange rates, the money supply).² For example, the bulk of the inflation tax in Bolivia in 1985-1986 was eliminated by increasing the government's tax receipts.

Nonetheless, slowing down the growth rate of nominal aggregate demand not only dampens inflation but also frequently sets off a recession. This is particularly true in situations marked by persistently high rates of inflation; the very indexation and expectations which make it tolerable to live with high inflation also make it difficult to lower it, since they tend to perpetuate the existing rate; thus, a slowdown in aggregate demand chiefly affects production rather than prices.

Even if the government presents a sound, consistent, broad-based stabilization programme, there is no guarantee that the authorities will persevere in its implementation in the face of the problems which will inevitably arise. When there is a credibility gap, the private sector assumes that inflation will fall less than the authorities expect it to, thereby bringing on a recession. Thus, a vicious circle is created. Prices do not fall—even though aggregate demand is being controlled—because everybody wants to see results before they reduce their price markups. If everybody acts in this manner, the programme may be more costly than necessary and, therefore, more difficult to maintain.

Finally, the above is often associated with a lack of coordination. Even if each individual agent believes in the soundness of the programme and in the need for its continuation, he will not gear his own price increases to targeted inflation rates unless he is sure that the other agents—especially his suppliers—will do the same. This is because he runs the risk of sustaining heavy losses if he reduces his price increases so as to align them with the targeted

inflation rate but his suppliers reduce theirs more slowly. When such uncertainty exists regarding the behaviour of other economic agents, the sensible course of action is to slow down price hikes, but not as much as called for by the authorities' target figure. Since the same line of reasoning is valid for all economic agents, average prices can be expected to remain above their equilibrium level; this will usher in a downturn in economic activity, since nominal aggregate demand will be insufficient to maintain real sales and production at that price level.

In order to reduce inflation on a lasting basis at a minimum recessionary cost, a combination of policies should be used to attack both the fundamental factors (especially the fiscal deficit and its causes) and the factors which perpetuate it (factors stemming from indexation, expectations, the credibility gap and poor coordination). Only Israel and, to a lesser extent, Mexico have managed to put together such a policy package. The relative importance of each type of policy will depend on the situation in each individual case, and especially on the extent of inertial inflation and the influence of de-stabilizing factors that could spark an inflationary flare-up. As a general rule, however, all such programmes need to include policies to curb aggregate demand, correct relative prices and keep expectations in check. In many cases, however (including those of the Cruzado Plan in Brazil, the Inti Plan in Peru and the Austral Plan in Argentina), pricing and de-indexation policies applied in the region have not been coupled with appropriate measures for controlling aggregate demand (see box III-2).

Such a programme should also provide for certain institutional and structural reforms, especially with respect to government spending, as well as signals regarding the future direction of economic strategy, so that, once the economy has been stabilized, it will remain so and the country can soon set out once again on a sustained growth path.

In addition, since any stabilization programme —no matter how well designed it

may be— tends to have too heavy an impact on some groups, consideration should be given at the very outset to the formulation of temporary compensatory measures which will place a limit on just how far incomes may fall.

A final point to bear in mind in this connection is that in those countries which have implemented successful stabilization initiatives (e.g., Bolivia, Costa Rica and Mexico), as well as moderate-inflation countries such as Chile and Colombia, a series of complementary policy tools have been used —in combination with the policies aimed at containing aggregate demand, correcting relative prices and controlling expectations— which have helped to offset the effects of the fiscal adjustment during the stabilization process (see box III-3).

4. The implementation of a stabilization programme at a minimum recessionary and distributive cost

The goal of making simultaneous progress in the areas of growth and social equity should also be reflected in the types of action undertaken during the stabilization phase. The forceful lessons of the 1980s provide a basis for a number of proposed guidelines in the following five spheres of State action: controlling aggregate demand, keeping expectations in check, correcting relative prices, implementing compensatory distributive policies, and carrying out institutional reforms. Some observations regarding the longer term are also called for.

a) *Controlling aggregate demand*

At this point in time, the implementation of a fiscal adjustment is the main condition that must be fulfilled in order to reduce inflation and bring aggregate demand under control. Under certain circumstances, once an economy has been stabilized and credit is restored, the public sector may be able to operate in the presence of temporarily greater imbalances than can be tolerated during the early stages. At the outset of

Box III-2

HETERODOX STABILIZATION PROGRAMMES

Argentina (1985), Israel (1985), Peru (1985), Brazil (1986) and Mexico (1987) have all launched stabilization programmes which, in addition to the traditional type of policy for controlling aggregate demand as a means of quelling core inflationary pressures, have emphasized the use of price, income and de-indexation policies (hence their description as "heterodox"). This latter step was taken on the basis of a social consensus in Israel and Mexico, and by decree in the other countries. Except in Mexico, where the programme's implementation was more gradual, an initial freeze was instituted following the adjustment of the most seriously misaligned relative prices. In addition, in Argentina, Brazil and Peru an ingenious monetary reform was undertaken in conjunction with the freeze in order to minimize its random redistributive impact on contracts signed in the final days before the freeze that were based on the assumption that the existing high rate of inflation (15%-30% per month) would continue.

Inflation plummeted immediately without causing any major economic contraction, and this generated confidence and gave the programmes credibility. These results were short-lived in Brazil and Peru, however, owing to the misalignment of demand—which wiped out the initial trade surplus and ultimately caused inflation to rebound. Eventually, Argentina's programme also ended in failure because sufficient means of controlling the fiscal deficit were lacking, thereby creating a situation which was further exacerbated by a deterioration in the country's terms of trade, a slump in its production of exportable grains and the pressure which this exerted on the exchange rate.

Both the Mexican and Israeli plans, however, have succeeded in lowering inflation without any major recessionary impacts. In both instances, steps were taken to keep the fiscal deficit under control. In the case of Israel, the strong additional financial support provided for the plan by the United States Government (equivalent to over 3.5% of GDP during 1985 and 1986) was an especially important factor. These funds were not used, but their presence nonetheless forestalled any run against the local currency. In Mexico, the agreement reached with creditors eased the pressure on the exchange rate for a time and thus made it unnecessary to set a high domestic interest rate in order to shore up the local currency.

These five experiments demonstrate that a price and income policy can be effective in reducing inflation (the inertial component thereof) without bringing on a recession, but its effect will not be long-lived unless it is coupled with policies that attack the "fundamental" imbalances: the fiscal and external deficits. The success of efforts to eliminate the external deficit will be determined by the domestic policies that are applied, the agreements signed with the banks, the amount of support forthcoming from multilateral institutions and countries of the centre, and, of course, positive or negative developments in the external economic environment as a whole (terms of trade, international interest rate, depreciation of the dollar, etc.).

MAIN FEATURES OF HETERODOX STABILIZATION PROGRAMMES

	Price and wage controls	Control of aggregate demand	Elimination of external deficit	Results
Israel	Yes (consensus)	Yes	Yes (aid from United States)	Lasting, no recession
Mexico	Yes (consensus)	Yes (operating deficit eliminated before plan)	Yes (agreement with banks)	Lasting, with mini-recession
Argentina	Yes (decree)	Insufficient	No/insufficient (negative external position in 1986)	Temporary
Brazil	Yes (decree)	No (misaligned)	No (initial surplus and improvement in terms of trade overturned by demand misalignment)	Temporary
Peru	Yes (decree)	No (misaligned)	No (unilateral limitation of interest payments helped, but misalignment of demand wiped out trade surplus and depleted reserves)	Temporary

Box III-3

MEANS OF COMPLEMENTING ECONOMIC POLICY DURING THE STABILIZATION PROCESS

Wage policy, external trade policies and an adequate supply of external resources are some of the main tools which can be used to complement economic policy during a stabilization process.

In Colombia, for example, the availability of the international reserves which had been accumulated during the pre-crisis period was extremely helpful in making the country's external and internal adjustment a more gradual and less costly process than it would otherwise have been. In Costa Rica, grants from the United States Government and the rapid re-establishment of external credit enabled the country to channel enough funds to the importation of intermediate products to forestall a slump in production, as well as helping to narrow the external deficit without a sharp devaluation. In Bolivia, the suspension of service payments on debts with private international banks, together with the compensatory and structural adjustment loans granted by the IMF in 1986, played an essential role in clearing up the country's external accounts.

In a recessionary situation, preventing real wages from dropping below a given level by establishing a wage floor, or long-term "equilibrium wage", is a fully justified measure. This is because in recessions sparked by flagging sales, the demand for labour is largely determined by sales levels rather than by costs, and a decline in real wages therefore does not serve as an effective stimulus for employment. Thus, Costa Rica's and Colombia's decision to maintain the minimum wage above a pre-established wage floor helped to prevent their fiscal adjustments from having a regressive impact.

Finally, in view of the fact that a devaluation of the local currency can weaken demand in the short run (since domestic demand will fall more rapidly than exports will expand, owing to the lag in the reallocation of resources to tradeables), the establishment of tariff surcharges and additional export incentives on a temporary basis may be called for during the transition period.* Such measures were adopted in Colombia, where they helped to bolster domestic supply and to head off a recession during its external adjustment process; these mechanisms then began to be phased out in 1986.

* Surcharges will inevitably exert upward pressure on prices; when they are applied to products that compete with locally-produced goods in oligopolistic sectors of the market, they may lead to larger markups; if they are applied to non-competing intermediate goods, they may dampen demand, which is precisely what they are intended to prevent.

a stabilization programme, however, fiscal accounts must be balanced.

Just how great a fiscal adjustment will be needed at the start of a stabilization programme and what effect this adjustment will have on employment levels will primarily depend on the programme's initial success in lowering the rate of inflation by acting directly upon inertial factors and expectations. If it is highly successful at the outset (as in the case of the Austral Plan), the fiscal adjustment will still be just as necessary, but it will not have to be as great as otherwise. There are two reasons for this.

Firstly, in the presence of high inflation rates, the bulk of the interest on the domestic public debt corresponds to the inflation-induced decrease in the real value of the debt principal

and thus represents an accelerated amortization (i.e., a capital outlay) rather than a current expenditure; the higher the inflation rate, the higher the interest payments on the public debt and the larger the deficit (as defined in the conventional sense of the term). The payments corresponding to the inflationary component of the interest rate may be financed through greater borrowing in nominal terms without adding to the real debt. Conversely, the lower inflation is, the lower the nominal interest rate will be; accordingly, interest payments and the conventionally-defined deficit will automatically decrease during a successful stabilization programme. The deficit which must be reduced is not the deficit which appears on the usual sort of accounting sheets (i.e., the nominal deficit), but rather the deficit minus the inflationary

component of interest payments (i.e., the operating deficit), since it is this latter deficit which, in the final analysis, accounts for increases or decreases in inflation.^{3 4}

Secondly, as the stabilization programme succeeds in reducing inflation by attacking inertial and expectation-related factors, real tax revenues will tend to rise, since they will be less severely eroded during the inevitable lag between the generation of the income to be taxed and the collection of those taxes (Olivera-Tanzi effect). Thus, for example, it was estimated that a stabilization programme in Mexico could boost real receipts by 0.7% of GDP by this means; consequently, the effective deficit in 1986 was not equivalent to 16% of GDP (the nominal deficit) or even 2% of GDP (the operating deficit), but actually just slightly more than 1% of GDP.⁵ The fiscal adjustment that is actually required will therefore be that which is necessary to reduce the operating deficit, after it is adjusted for the increase in tax revenues produced by the stabilization effort.

If the programme does not manage to reduce inflation during an initial phase by addressing its inertial and expectation-related components, then the situation becomes much more difficult and the probability of recessionary impacts mounts. In such instances, the initial adjustment required in public-sector accounts will be greater; in extreme cases, it may reach the point where it is equivalent to the nominal deficit. As progress is made in slowing down the rate of inflation, it will become possible to gradually diminish the severity of the fiscal adjustment *pari passu* with the manifestation of this slowdown's positive effects on the deficit.

The fact should be borne in mind, however, that the positive effects which this slowdown in inflation has on the public deficit will be transformed into negative effects if inflation speeds up again in response to internal or external impacts, including changes in expectations. Accordingly, any anti-inflationary strategy should include means of dealing with occasional inflationary flare-ups.

Obviously, the public deficit can be lowered either by raising income or reducing

expenditure. Revenues may be increased not only by charging higher rates for public services or raising tax rates, but also by increasing receipts by means of an expansion of the tax base, the indexation of taxes subject to collection lags, the reduction of multiple tax exemptions or the reduction of tax evasion. By the same token, expenditures can be reduced not only by lowering already depressed wages or investment levels or by reducing public-sector employment, but also by reducing subsidies (and targeting them more accurately), setting the interest rates for public credit at positive real levels and cutting the financial costs associated with domestic and external debts (whether by obtaining a lower interest rate or through write-downs).

Although these measures' effects on nominal aggregate demand are similar, their consequences in terms of both the risk of recession and social equity are not. For example, in some cases the required adjustment in fiscal accounts will entail steep cuts in subsidies on mass consumption goods, which may have very harmful effects on the lower-income segments of the population. In some instances the most serious social impacts of such measures can be mitigated by aiming subsidies specifically at the lowest-income groups.

It is also obvious that the greater the feasibility of basing a fiscal adjustment on reductions in interest payments on the external debt, the lower its cost to the country will be. Even if it is only during the initiative's early stages, reducing the transfer of resources abroad may play a key role by gaining time for the plan until other fiscal measures (many of which may take some time to make their effect felt) produce results. Hence, fresh credits or the total or partial deferral of interest payments may provide the breathing space needed to build up confidence in the stability of the currency—a crucial factor in any stabilization programme—and thus forestall a speculative run on the dollar and against the local currency. It is by no means irrelevant to note that during the successful stabilization programmes of Costa Rica (1982), Bolivia (1985), Israel (1986) and

Germany (1923), either debt servicing was suspended or strong external financial support was forthcoming. This is not, however, a sufficient condition in and of itself to lower inflation. When the funds made available by a reduction in debt service are used to increase other fiscal expenditures —or, in other words, when a policy of fiscal imbalance continues to be pursued, as was done in Brazil during the final days of the Cruzado Plan

and in Peru starting in 1986— this abuse of the greater freedom of action afforded by the service reduction will perpetuate existing inflationary pressures, even though their source will have shifted from the external to the internal sphere.

Indeed, the external and fiscal deficits often fuel each other through the mechanism of the exchange rate: on the one hand, a run against the local currency boosts the parallel

Box III-4

IMPLEMENTATION OF A FISCAL ADJUSTMENT

A number of successful fiscal adjustment initiatives were carried out in the 1980s. The large-scale efforts undertaken by Bolivia, Chile, Colombia, Costa Rica and Mexico all prospered, thanks to the fact that in almost all of these countries, the public sector generally had a surplus of foreign exchange either because it was the owner of the country's main tradeable natural resource or because a large part of its tax revenue was derived from that resource. However, when public finances are overly vulnerable to the price fluctuations of a key export, then the external and fiscal deficits will fuel one another: in a positive sense when the international price rises (e.g., copper in the 1980s) and in a negative sense when it falls (e.g., petroleum)."

The reduction of Bolivia's fiscal deficit in late 1985 following its bout with hyperinflation was a particularly striking achievement. In fact, 75% of this reduction (over 7% of GDP) was the result of a decision to sell fuel on the domestic market at international prices calculated on the basis of the new exchange rate (following the maxi-devaluation) and, later, to levy a fuel tax. The remainder was made possible by spending cuts (investment and current expenditure) which went so far as to include a moratorium on interest payments on the external debt. The adjustment gained in credibility with the establishment of the principle that expenditures would not be made until the Treasury had the necessary resources (income) on hand. The 1986 tax reform^{***} helped the country to consolidate this reduction, since it could then count on a greater flow of income on a permanent basis rather than relying solely on temporary spending cuts; this was particularly helpful because it would have been counterproductive to try to sustain some of the reductions —such as those applying to social expenditures and investment— for a protracted period of time.

Chile's fiscal adjustment is especially noteworthy because, despite the large deficits it ran up in 1982-1985, at no time during the decade was its annual inflation rate above 30%. This is largely a result of the fact that —thanks to the tax reforms, cuts in current expenditure, improvements in the management of public enterprises and other steps taken in the 1970s— when the crisis hit Chile, the government had a fiscal surplus, inflation was very low and the public sector's domestic debt was quite small. Consequently, the Treasury was able to borrow heavily on the domestic market so as to gain time until the effects of other policies made themselves felt. A particularly important role was played by the devaluations implemented from 1982 onward —owing to a shortage of foreign exchange— which automatically boosted the level of fiscal income derived from copper. In fact, the net impact of the other measures taken following the crisis was of no more than minor significance.

* The instability of oil prices and particularly the sharp decreases seen in 1982 and 1986 have hindered Mexico's efforts to eliminate its deficit. The resulting drop in fiscal income has been compounded by a loss of confidence in the stability of the exchange rate and of real domestic interest rates, which will have to climb in order to prevent or limit capital flight. This is why the external and fiscal deficits fuel one another, either negatively (when there is a lack of confidence as regards the external deficit, as was the case before the 1989 agreement with creditor banks) or positively (when the outlook is promising, as was the case when, following this agreement, the domestic interest rate fell, thereby reducing the service on the domestic and external debts).

*** This included the replacement of the sales tax with a value added tax and the broadening of the tax base.

Box III-4 (concl.)

MAIN FISCAL ADJUSTMENT MECHANISMS USED DURING STABILIZATION PROGRAMMES

	Increase in income	Reduction in expenditure	External financing	Other policies
Colombia 1983-1986	1983 tax reform: income, sales, municipal and departmental taxes	Reduction of public investment Real wage cuts in public sector		
Costa Rica 1982-1983	Substantial increases in prices charged by public- sector firms Increase in tax rates: personal income and profit taxes Foreign trade, sales and excise tax surcharges		Grants from United States Government External credit	
Chile 1975-1978	Fiscal reform: VAT and control of tax evasion Correction of prices charged by public firms	Lay-offs of public employees Wage cuts Reduction in public investment		Increase in fiscal income via devaluation and higher copper prices
Mexico 1988-1989	Control of tax evasion	Wage cuts Reduction in public investment	Agreement with creditor banks	Consensus-based setting of prices and wages
Bolivia 1985-1986	Gasoline tax Tax reform: VAT	Wage freeze Lay-offs of public employees	Suspension of service payments on external debt	Increase in fiscal income via devaluation

exchange rate and puts pressure on prices both directly (in the form of costs) and indirectly (via expectations); on the other hand, the domestic interest rate will rise in order to offset the pressure on the exchange rate, and this will increase the fiscal expenditure (and deficit) required to make interest payments on the domestic debt.

In order to avoid a recession, preference has to be given to deficit-cutting measures that affect the bulk of the economy rather than to those which focus on just a few activities (which virtually ensures that there will be adjustments in terms of quantities rather than only in prices), except in the case of clearly misaligned rates and charges for public services. This necessarily entails a presumption in favour of a reduction of the deficit via increased revenues rather than decreased expenditure, since the effect on an economy of an increase in public revenue is generally more evenly distributed than is the effect of a reduction in spending.⁶ Moreover, since it affects the private sector, which is the same sector that benefits from the expansionary influence of a reduction in the inflation tax, it is likely that the necessary adjustments will be effected through a slowdown of price increases rather than of production. In contrast, since public expenditure is concentrated in public services or construction, a cut in government spending will put the burden of the adjustment on the shoulders of a small fraction of the economy; in addition to being inequitable, this also increases the probability that the slackening of demand will not only check inflation but will curb production as well. These factors appear to be part of the reason for the relative successfulness of the Israeli and Bolivian programmes, for example, inasmuch as 75% of the reduction in their deficits was accomplished through broad-based increases in revenue.

For similar short-term reasons, it is preferable to restrict public spending on wages rather than on employment, since wage cuts (slower increases) reduce expenditures on services but not the volume of services, whereas a decline in employment tends to decrease the volume of services itself (as well as having more

regressive distributive effects). It is also necessary to refrain, if at all possible, from reducing investment because this will decrease the volume of present and future output.⁷ If such cuts cannot be avoided, then they should be concentrated in areas where the depressive effect on private investment will be minimized rather than in those areas of public investment which are particularly complementary to private investment. In addition, in order to ward off foreign-exchange problems, in the short run emphasis should be placed on the types of public investments which are less intensive in imported equipment, such as infrastructure and human resources projects. In any event, this lower level of investment, as is also true of any possible sale of assets, is a short-term expedient which does not lay the groundwork for a continuing equilibrium.

In addition to all the above considerations, there is also another more general type of argument—having to do with the rationale underlying the collective decisions implicit in the public budget—for basing deficit-reduction efforts on increases in revenue rather than on spending cuts. The pattern of public expenditure in a high-inflation situation is not necessarily the outcome of a systematic decision-making process. It is likely that, owing to distortions in the allocation of expenditure as well as to financing constraints, not all essential collective needs can be met. Thus, although there may be a great deal of manoeuvring room as regards the distribution of expenditure, it is to be hoped that the desired cuts in some areas will be counterbalanced by the satisfaction of legitimate demands for increases in others. Since inflation is a type of "tax" which arises out of a lack of alternative sources of funding, it would seem reasonable for a large part of the reduction in the deficit to be based on the replacement of that tax with explicit taxes, such that more or less the same level of effective taxation as had been reached with the addition of the "inflation tax" will be maintained.

Finally, the counterpart of the reduction of the deficit is a decrease in the growth rate of the money supply. This will act, in effect, as one of

the programme's "nominal anchors". In theory, a decline in inflation will boost the demand for money, and the money supply should therefore be expanded in order to remonetize the economy and head off a recession. The credibility of a stabilization programme that starts out by expanding the monetary base may well be questionable, however. Therefore, in the beginning—at least until a sharp reduction in inflation has been achieved—it would seem wise to curb liquidity and keep interest rates high (although they would still be decreasing), while counting on the fact that aggregate demand will remain at an adequate level during the early stages as a result of the increase in consumption by lower-income sectors in response to the decrease in the "inflation tax".

b) *Keeping expectations in check*

As noted above, inflationary expectations tend to be somewhat rigid. Consequently, if the slowdown in nominal aggregate demand is not coupled with a policy that helps steer expectations towards the targeted rate of inflation, then inflation will fall more slowly than planned and a recession will ensue. Under such circumstances, stabilization programmes should include a *temporary* policy on key prices and sources of income designed to guide or control the movement of the nominal values of critical variables (wages, the exchange rate, interest rates, the prices of key products) so that they will slow their pace simultaneously and uniformly in line with the inflation rate called for by the programme.

It should also be borne in mind that the way in which policy announcements and measures will influence expectations depends to a great extent on the type of inflation affecting the economy and the past experiences of economic agents; a given measure may be effective in some cases but be counterproductive in others. Expectations are influenced by a wide array of signals, and a great deal depends on the "model" being used by the various types of economic agents. In general, however, the

government should seek to "anchor" the programme in a set of variables or key prices so that no one nominal variable (usually the growth of the money supply) need bear the entire weight of the stabilization effort.

In cases where major price distortions exist, it may not be possible to launch a programme until the price system has been put in order. Nonetheless, in many cases it appears to be unwise to opt for a sudden, complete decontrol of prices and interest rates—as is often done in orthodox stabilization programmes—at the very outset of a stabilization process whose success hinges, in large part, on the behaviour of expectations regarding inflation. However, in contrast to what tends to happen with traditional systems of price controls, this step should be taken for the purpose of bringing key variables as close as possible to their ultimate equilibrium levels, rather than as a means of repressing inflation. Similarly, unlike traditional price controls—which are generally applied to agricultural products because such goods carry a great deal of weight in the shopping basket of consumer goods—these controls should be focused on industrial prices, which tend to be more strongly affected by inflationary expectations. The aim is to control expectations rather than to repress inflation.

It is also important to realize that decision-makers cannot set just any inflation target they wish. The target has to be in keeping with the extent of monetary and fiscal control that can be attained. If the proposed degree of control exceeds the bounds of credibility, then the programme will suffer from internal inconsistencies which will generate expectations that prices will actually rise more than planned.

Since these policies lower inflation quickly, they set up a *virtuous* circle so long as they are in effect. The programme's good results ensure the programme's credibility, and this reduces the speculative demand for dollars, increases the demand for money and boosts real tax receipts. However, for analogous reasons this process

may also reverse itself and set up a *vicious circle* if it is not complemented by the other policies in force.

The implementation of price, income and de-indexation policies will vary depending on the level of inflation. For example, in hyperinflationary situations, it will suffice to control one price —the exchange rate— in order to regulate and synchronize all other price movements because in a dollarized economy all other prices will be adjusted in line with the price of the free-market dollar (e.g., Bolivia in 1985). However, in situations where inflation is persistently high but does not reach the level of hyperinflation (10%-30% per month, as was the case in Argentina, Brazil and Peru), prices tend to be readjusted on the basis of various indicators (the consumer price index, interest rates, unit cost of labour) rather than solely on the free-market exchange rate. Under these circumstances, a price and income policy will therefore have to anchor a *number* of prices in order to synchronize price trends and bring them into line with the level of inflation provided for in the programme so as to prevent lags in key prices and the subsequent failure of the stabilization effort. The history of the region is replete with examples of stabilization programmes that ended in failure because they concentrated on controlling aggregate demand and just *one* key price (either the exchange rate or wages), thereby generating an exchange rate lag that eventually reached a breaking point (Southern Cone, 1978-1982) or a highly regressive or recessionary lag in wages (Argentina, 1976-1978; Chile, 1973-1975; Mexico, 1982-1985).

These controls should be maintained only long enough to give credibility to the idea that inflation will not rebound to its historical levels when prices are unfrozen. In other words, it is a matter of wiping out the memory of high inflation without causing the existing low rate of inflation to be seen as artificial or a product of repression.

c) *Correcting relative prices*

Another very real difficulty that must be dealt with by stabilization programmes is that in most cases of inflation —except in the highly unlikely event that the inflation is wholly inertial (as would be the case if the fiscal operating deficit were near zero) and free of any de-stabilizing component— price rises are not evenly distributed across the board.

These lags (and, hence, advances) in relative prices are brought about by sharp, unexpected changes either in supply (caused, for example, by a drought) or demand (wide swings in export prices) or in economic policy (adjustment policies). When this happens, any of the following, among others, may lag far behind other prices: i) the exchange rate (which will have an adverse effect on the balance of payments); ii) public rates and charges (which will push up the fiscal deficit); iii) agricultural prices (which will slow the increase in production of staple foods); iv) interest rates (which will hinder an efficient allocation of investment as well as sparking a sharp and unjustified redistribution of income from savers to debtors); and v) real wages (which will redistribute income regressively and will tend to generate a contraction in production sectors that supply the domestic market).

Consequently, if the stabilization programme is to be long-lasting and effective rather than doing no more than making a temporary dent in inflation, these imbalances in relative prices will have to be corrected. The readjustment of lagging or repressed prices may be regarded (albeit erroneously) by economic agents as an indicator of the probable level of future inflation rather than as simply a corrective adjustment, and inflationary expectations may exceed the implicit inflation target of monetary and fiscal policy as a result. Therefore, the number, frequency and size of these corrective adjustment should be kept to an absolute minimum.

The adjustment of the exchange rate is a particularly crucial correction, since the elimination of the external deficit largely depends on there being a high, stable exchange rate. The correction of the exchange rate has important fiscal implications as well. Indeed, in countries where the public sector usually has a surplus of foreign exchange —because it is the owner of the country's main exportable natural resource or derives a large part of its tax revenue from it— a real devaluation will not only narrow the external deficit but will also automatically reduce the fiscal deficit as well. Just the opposite occurs in countries where the public sector is a net purchaser of foreign exchange. In that event, the devaluation needed in order to reduce the external deficit will transfer resources to the private sector, thereby widening the fiscal deficit. Consequently, the fiscal adjustment will have to be even greater. It therefore comes as no surprise that some of the most outstanding examples of significant, stable fiscal adjustments are provided by Bolivia, Chile, Colombia and Mexico —all of which are countries where the public sector is the owner of the main natural-resource export and therefore benefits from a devaluation.

The setting of the exchange rate at a high real level is not a one-time affair, however. It must be kept stable, since the reallocation of resources is a gradual process that requires consistent incentives in order to take effect. In addition, a high exchange rate (in real terms) means that the prices of non-tradeables will rise more slowly than the rate of devaluation. Wages, in particular, have to decrease relative to the exchange rate in order to stimulate production of tradeable goods and services, whose rate of return will therefore rise, but they have to increase relative to tradeables (so that the rate of return of these activities will decline, thereby sparking a shift in investment towards the production of tradeable goods and services). The ultimate effect in terms of the size of the drop in real wages in the short term will depend on many different factors, including the fall in total demand, the values of the relevant elasticities, the speed with which tradeables-

producing sectors absorb manpower, the relative size of such sectors in terms of total output, and the nature of tradeable and non-tradeable goods (food, minerals, etc.).

In order to strengthen a stabilization programme's credibility, relative prices should not necessarily be set at their equilibrium levels but rather at levels which the public regards as sustainable and which will therefore help prevent the flight of capital away from the local currency and towards merchandise or convertible currencies. Unfortunately, if such corrections of relative prices are overdone, this also has its costs —at least if the intention is to keep the prices at those levels for some time— because this pushes aggregate demand below its equilibrium level. These recessionary pressures will fuel one another if, based on much the same line of reasoning, public rates and charges are set higher than what is needed, the money supply's growth rate is lowered more than necessary (overlooking the fact that, as inflation slows, the demand for money will expand) and wages are curbed more than is required. If this occurs, policy makers will be faced with a trade-off; the choice is then whether to set prices at equilibrium levels (and run the risk that the general public will have no faith in their stability, which will cause the programme to fail) or to overdo some of these corrections so as to foster the programme's credibility (thus risking a recession). The best course of action seems to be to over-correct two of the most readily adaptable key prices —the exchange rate and the interest rate— enough at the outset of the programme to discourage a run on the dollar or on goods and against the local currency. Once inflation has slackened and the programme has gained in credibility accordingly, then the authorities will be able to ease up a bit, letting the real exchange rate slide towards a longer-term equilibrium level; in its turn, the money supply will be able to expand in step with the demand for money so as to prevent real interest rates from reaching excessive levels and to boost the system's liquidity. In theory, it is a simple enough matter to resolve this problem; what is difficult is to determine when it is the proper

time to act and the amount by which equilibrium values will have to be temporarily exceeded. Nevertheless, the nature of the trade-off between credibility and equilibrium is as stated above, and these two needs must be continually balanced in order to prevent either the failure of the stabilization effort or a long, costly recession.

Nor is it simply a question of setting key prices at the right levels and coordinating them, but rather of plotting out an equilibrium path. This entails, for example, making a commitment to maintaining a high real exchange rate and to keeping it stable in the future, limiting the size of wage hikes to the amount by which productivity increases, curbing consumption in general and consumption of non-essential goods in particular, and maintaining real interest rates at positive levels which are higher than real international rates but yet not too high (except, perhaps, on a temporary basis during the critical early days of the stabilization programme).

d) *Compensatory distributive policies*

Even if the stabilization programme succeeds in sharply reducing inflation without causing a serious decrease in output or employment, the dislocation of relative prices and of the structure of production may occasion losses on the part of some already vulnerable groups. Therefore, a given quantity of resources will have to be set aside in order to provide at least a minimal *safety net* during the transition.

In determining exactly how these resources ought to be used, an effort should be made to identify fast-acting measures which will provide the most efficient means of channeling these compensatory resources to the most severely affected groups while disturbing relative prices and public finances as little as possible. Examples of such types of initiatives include the creation of the National Social Equalization Fund and the Revolving Fund for Social Development in Costa Rica to

address matters relating to employment, housing and nutrition, land distribution and the promotion of cooperatives. Other examples include Chile's emergency employment programmes and Bolivia's Emergency Social Welfare Fund, a programme set up in connection with World Bank structural adjustment loans which has opened up employment opportunities on the basis of small-scale, labour-intensive projects run by municipalities, community organizations and non-government organizations.

The application of measures of this sort requires a certain amount of management capacity (in order, for example, to keep "leaks" to a minimum) as well as sound judgement and decision-making capabilities (in order to determine, for example, how assistance should be distributed among poor people in general versus those who have only recently joined the ranks of the poor as a consequence of the present economic situation). Be that as it may, policy makers must content themselves with broad-coverage compensatory measures during this phase, while relying on the fact that the drop in inflation and the reduction of the inflation "tax" will probably have a particularly beneficial effect —as discussed earlier— on lower-income groups, especially if these things have been accomplished without causing a recession.

The introduction of more permanent means of offsetting any regressive effects that the stabilization programme may have will depend upon the State's ability to gradually convert the fiscal balance achieved through emergency measures into a stronger and more solid fiscal position founded upon a broad tax base and a relatively simple and, in so far as possible, progressive tax system coupled with a more progressive pattern of expenditure. Of course, in order to do this, a new pattern of distribution among economic agents will have to be established or agreed upon. Means of meeting this challenge are discussed in other chapters of this document.

e) *Institutional reforms*

The amount of latitude that exists for economic policy is exceedingly limited owing to institutional factors which make it difficult to balance public finances and to keep them under control.

Firstly, central government authorities have control over only a portion of public expenditure. The adjustments they make may be cancelled out by maladjustments in other public-sector agencies over which fiscal policy makers have no direct control (e.g., regional governments, public enterprises, State and provincial banks) and whose deficits are usually absorbed *ex post facto* by the central government. So long as the autonomy of these bodies in respect of expenditure is not matched by a corresponding autonomy as regards their financial liability, a de-stabilizing, asymmetrical relationship will continue to exist whereby the deficits of decentralized bodies are transmitted to the central government but their surpluses will tend to stay where they are generated.

Secondly, the possibility of authorizing expenditures without, at the same time, having to ensure their financing exposes the budgetary process to virtually unlimited pressure, since all expenditures appear to be justified, especially when the individual item is small in relation to total expenditure or the deficit. After all, everybody wants more benefits, lower taxes and a smaller deficit—but it may be that these objectives cannot all be achieved simultaneously. Thus, the budgetary process needs to be such that expenditures and their financing must be approved at the same time; this provides a means of introducing checks and balances together with fiscal discipline into the realm of public finances.⁸ This was the reason why Costa Rica chose to centralize its budget; a single, consolidated budget was created for the entire public sector (this had not existed prior to the 1981-1982 crisis) and the financial operations of each body were made subject to the directives issued by the central government.

Thirdly, the policy on public-sector employment, which in most stabilization efforts

is based on short-term considerations, should be viewed as part of the process of restructuring the public sector rather than as an anti-inflationary tool.

One could go on and on, but the main point is that the fiscal adjustment should not only reduce the deficit, but should also go hand in hand with institutional reforms, both in and outside the public sector, that will prove more manoeuvring room for economic policy and thereby increase its effectiveness.

f) *The longer-term perspective*

In order to orient economic agents and lessen their uncertainty, it is important that short-term policies should be set within the longer-term framework of changing production patterns. Otherwise, a country runs the risk not only of involving itself in a long and costly stabilization process, but also of seeing its economy remain stagnant for a long time after the stabilization process has been completed. Therefore, although it may not be feasible to adopt a large number of long-term measures right at the start, it is important to outline or at least identify the cornerstones of the recovery process and the central features of the country's growth strategy; given the current state of affairs, these cornerstones will necessarily be investment and international competitiveness, as seen from the longer-term perspective of the effort to change production patterns with social equity on an environmentally sustainable basis.

Given the size of the external debt burden and the resulting shortage of foreign exchange, as well as the unremitting neglect of the export sector which has led, in practice, to an industrialization strategy oriented primarily towards domestic demand, it is reasonable to suppose that economic growth will have to be led by the dissemination of technical progress and its absorption into the production process with a view to increasing competitiveness. If there is any "infant industry" today, it is the penetration and winning over of new external markets in which technical progress and

economies of scale can be used to full advantage.

Owing to the lack of enough internal and external saving to raise investment, export growth and efficient import substitution will have to be based, in the beginning, on a reallocation and better utilization of currently idle installed capacity and will have to be financed in large part, as was suggested in the preceding chapter, by means of an at least temporary reduction in the amount of resources being transferred abroad.

The increasing use of idle capacity to produce exports—to the extent that existing production capacity is suited to this alternative use—would help to narrow the external deficit. However, unless a greater percentage of new income is channelled to saving and investment, the region will not be able (owing to the large-scale transfer of resources abroad) to attain suitable levels of investment (in excess of 20% of GDP). Hence, the recovery should be led not only by exports (to eliminate the external deficit) but also by investment (to eliminate the production gap).

The need to encourage saving and investment suggests the advisability of discouraging consumption as well as of promoting investment *per se*. Measures designed to attain this end would include the formulation of a tax policy that favours the reinvestment of profits over their distribution and provides for a progressive income tax with exemptions for funds channelled to direct or financial investment. In addition, until the crisis is overcome, the tendency will be to limit the size of general wage adjustments⁹ to the amount by which productivity has increased.

Finally, steps will also have to be taken to put the countries' weakened financial systems back on a sound footing and to increase their regulation in order to ensure that they perform their function of attracting savings and channelling them to the expansion of profitable production activities within a more open and stable economic environment.

Notes

¹ Following the Second World War, some hyperinflationary episodes were brought under control without pushing the country into a recession. More recently, Indonesia lowered its annual inflation from 1 000% to 10% between 1965 and 1970 without sacrificing its growth; Bolivia reduced its rate from 63% in 1974 to 11% in 1975 while growing by 6%; and Uruguay brought its annual rate of inflation down from 125% in 1968 to 20% in 1969 without sliding into a recession.

² However, in countries where the tax base is not broad enough to permit higher taxes, increases in the rates charged for public services have sometimes prompted substantial changes in relative prices, as occurred when fuel prices were raised in Bolivia.

³ If the nominal interest rate remains high (e.g., if expectations are not entirely under control), however, the country will find itself faced with a dilemma: if inflation actually falls, real interest rates and, hence, the operating deficit will be very high. Consequently, although the nominal deficit existing prior to the drop in inflation is not very indicative of the country's fiscal position, the nominal deficit that exists after a stabilization programme has been launched is indeed important to an understanding of policy trade-offs.

⁴ The difference between the two may be quite large; for example, whereas Mexico's nominal deficit was about 16% of GDP in 1986 (with an inflation rate of over 100%), its operating deficit amounted to 2%; in Brazil, these two deficits represented 30% and 6%, respectively, of GDP in 1987, while the rate of inflation was around 400%.

⁵ The magnitude of the necessary fiscal effort might be greater in countries where spending has been repressed and/or there is strong resistance to increases in effective taxation.

⁶ An important exception to the above may be the reduction of the costs of servicing the domestic debt or of financing (broad-coverage) subsidies. If domestic debt is held by a large number of economic agents, its re-denomination and restructuring may be an efficient and relatively painless way of reducing the deficit in tandem with the reduction of the inflation tax. The same type of argument is valid in the case of the reduction of relatively broad-coverage subsidies.

⁷ Unless the effect of cuts in investment expenditure in the construction sector can be translated into a slowdown in the rate of increase in prices of inputs—in which case the real volume of investment could be maintained at a lower nominal level of expenditure.

⁸ Another way of introducing a measure of financial discipline may be to prohibit the Central Bank from lending to the public sector. As we have seen, however, such a ban can be side-stepped by means of domestic borrowing and the sale of increasingly shorter-term securities to the public; in effect, these practices convert the Treasury into another issuing agent.

⁹ Nevertheless, in view of how severely the crisis has hurt the lowest-income groups, austerity measures will need to exempt the poorest 25% of the population, which not only lives in extreme poverty but also generally receives just 4% of national income. Efforts need to be made to help these people recover the ground they have lost and to correct this social imbalance in conjunction with the restoration of macroeconomic equilibria. Improving the status of this segment of the population will require an additional, but not impossible, belt-tightening effort on the part of the other 75% of the population; it would be necessary, for example, to reduce the latter group's share of national income from 96% to 95% or 94% in order to enlarge the income share of the poorest 25% of the population.

Chapter IV

STRENGTHENING OF PUBLIC FINANCES

1. Preliminary remarks

In the 1980s it was not only the development strategy followed after the war which ran into crisis but also the State which had promoted it. The crisis was sparked off and aggravated by the external debt burden, and in particular, by that portion of the latter accumulated by the State. This crisis of the State has its roots in the structural fragility of its finances, reflected on the one hand in the weakness and instability of its fiscal capacity compared with the rigidity of the institutions and expenditures which it must maintain and which are usually in a continuous process of expansion and diversification, and on the other hand by the growing disfunctionality of the State's interventions in economic and social activity. In the majority of the countries, the external and internal instability characteristic of the crisis decade weakened the macroeconomic and operational capacity of Latin American governments, leading to serious deterioration in critical sectors of their activities and thereby frequently eroding their social legitimacy.

In these circumstances, it has become a matter of the greatest urgency to carry out profound reforms of public policies and restructure the State itself. This is all the more necessary because a decided and effective stimulus on the part of the State is needed in order to carry through a strategy of changing production patterns with equity. The countries of the region are in fact currently engaged—with different degrees of progress or consolidation—in both these processes, the central core of

which is fiscal reform. Such reform constitutes the central element in reform of the State, both because of its consequences with regard to the capacity to mobilize resources in order to implement the public policies needed to promote changes in production patterns and greater equity, and because of its repercussions on the system of incentives for economic activities or its indirect effects on the distribution of well-being.

Fiscal reform seeks to modify the various public sector policy instruments (in the areas of taxation, public spending and financing of the State) in order to increase their effectiveness in achieving the above objectives. At the same time, it requires compliance with certain functional requisites which are of key importance for its consolidation: namely, a form of institutionalization which can guarantee both structural solidity in income and flexibility in the budgeting of expenditure; political and institutional viability of the reforms; and the administrative feasibility of the instruments used.

2. The components of progressive fiscal reform

Fiscal reform must take account of the various dimensions of equity (equality of opportunity, reduction of social inequalities, relief of poverty, security against impoverishment, etc.) on two interrelated levels: the assignment of greater resources for social policies (assuming also that these policies can be made more effective with

the existing resources), and improvement of the equity of the fiscal instruments themselves and indeed of all the types of resources mobilized by the State. All this involves carrying out various types of reforms:

i) Tax reforms which take account on the one hand of the level of tax burden needed to cover the functions which society demands from the State, and on the other hand, the equity of the tax structure.

ii) Budgetary reforms aimed at maintaining a given level of basic social security and public spending; the latter must be compatible with structurally balanced fiscal accounts, though it must make it possible to cover suitable amounts of public investment in economic and social infrastructure and reasonable minimum levels of social investment, that is to say, expenditure on social services which represent investment in human and community capital.

iii) Reforms of public enterprises aimed on the one hand at efficient resource allocation and expansion of fiscal capacity (among the applications of which are the policies most calculated to favour equity), as an indirect result of the reduction of the public deficit, the lowering of public investment requirements or the procurement of capital income, and, on the other hand, at the achievement of greater equity in property transfer schemes.

iv) Policy reforms which further the reduction of the external indebtedness of the State, in order to free resources which can be used —*inter alia*— for social policies.

One of the indispensable requisites for carrying out fiscal reform is the restoration of the macroeconomic balances through a stabilization programme (an issue already dealt with in the previous chapter), since without stabilization there can be no possibility of change or equity. This is why the fiscal adjustments already made or begun in recent years have been aimed mainly at achieving fiscal balance, most often accompanied by special restructuring action because stabilization was very urgently needed. Such stabilization is not of itself sufficient, however, for among the structural distortions that occurred in the fiscal

systems of the region in the past are such factors as constraints that make it difficult to obtain enough fiscal resources, distortions which militate against growth and well-being, and regressive skews or instruments which were not appropriate for promoting equity. Fiscal reform, then, calls for a much more integral conception of the problem than the mere balancing of the fiscal accounts. Every effort must be made to consolidate stabilization and the public finances on sounder bases as regards the level and composition of expenditure and income, as well as correcting the deformations and distortions of the fiscal system and giving it a more equitable orientation.

The progressiveness of the fiscal reform must be judged in terms of the net implications for the various social groups of the set of actions affecting taxation and the various forms of public spending. The equity of taxation and of public spending must be considered together: an increase in the tax burden based on a progressive tax structure may give rise to a neutral or even regressive structure of expenditure, thereby giving a net fiscal incidence which is only very slightly progressive or even regressive. Likewise, an increase in social expenditure which seems to be clearly favourable to lower income groups may be based on such regressive taxation that this cancels out part of the progressive redistribution.

Similarly, the reallocation of public spending in the direction of objectives considered to be socially desirable will have a net progressive effect only to the extent that this increase is effectively reflected in services provided to the lower income groups or if the previous destination of these resources involved expenditure of a regressive or neutral incidence. In the latter case, every group could have benefitted from it approximately in proportion to its income.

In view of this natural desire to secure fiscal progressiveness, the objections often made to progressive tax reforms on the grounds that it is more effective to redistribute well-being through expenditure than through the tax structure seem somewhat over-hasty. Even if a

maximum redistributive orientation is given to those types of expenditure which permit it and all possible measures are taken to "target" social programmes, there is still no reason to assume that this will make it possible to achieve such a high level of progressiveness that it will no longer be necessary to seek at the same time to maximize the contribution that the tax system can make to progressiveness of the fiscal system. Thus, putting all the redistributive responsibility of the State on one or the other side of the equation means adopting an extreme solution among the many which are possible. On the one hand, generally speaking, the tax systems of Latin America already have a slight degree of progressiveness, so that certain balanced increases in the tax burden will give the net result of the reform a progressive nature (see tables IV-1 and IV-2). On the other hand, tax reform can improve the progressiveness of the system both in theory and in practice.¹

3. Tax reform and equity

Tax reform is an essential part of the efforts to make adjustments and consolidate macroeconomic stability in which the countries of the region are engaged, for it goes a long way towards determining the State's fiscal capacity to finance its various functions, among which of course are social policies aimed at improving equity.

While recognizing the general principles, based on past experience, which are followed in designing tax reforms (especially those regarding the expansion of the tax base, simplification of tax administration, reduction of exemptions and rationalization of tax rates), the two basic questions which arise from the point of view of equity could be put as follows:

- Up to what point can the tax reforms carried out in the countries of the region provide the State with more resources for increasing its social expenditure?
- How far is it possible to improve equity without having to bring taxes into the

matter, and in particular, how far is it possible to reduce the tax burden on the poor?

a) *Increasing the tax burden*

To a greater or lesser extent, depending on the individual cases, the countries of the region are in a position to raise their tax burden. In the fiscal adjustments made during the crisis decade there were various attempts in this direction, although the periods of instability suffered by some countries affected the procurement of resources by the government in different ways. At the end of the crisis decade, the total fiscal burden, as a percentage of the product, varied considerably from one country to another, ranging from 25% in Costa Rica, Chile and Uruguay to 9% in Guatemala, with most of the levels standing somewhere between 19% and 25% (see table IV-3).

The burden in the countries of the region is substantially lower than that of the more developed OECD nations, where it is between 30% and 56% of the product. This comparison exaggerates the difference between the OECD and Latin America, however, since around 10 percentage points correspond to the higher cost and value of social security benefits in the OECD countries.² All in all, excluding social security and non-tax revenue (which, in the case of those countries of the region which are richly endowed with natural resources, raises fiscal income but reduces the private tax burden), the tax burden in the region is on average more than 10 percentage points of the gross domestic product lower than that of the OECD countries (see table IV-3). This suggests that there is substantial leeway for increasing the fiscal resources of the region without significantly affecting collective well-being or international competitiveness.

Furthermore, although the overall tax burden in most of the countries of the region is similar to that of the South-East Asian countries, the significantly greater role played by direct taxes in the latter nations not only suggests the

Table IV-1

ESTIMATES OF THE REDISTRIBUTIVE TENDENCIES OF TAXES ^a					
INDIRECT TAXES			DIRECT TAXES		
VAT	WITHOUT EXCEPTIONS	R	INCOME TAX	PERSONAL	VP
	WITH EXCEPTIONS	SP		UNEARNED INCOME	VP
FUELS		SP	WEALTH		VP
SPECIFIC TAXES	TOBACCO	R	INHERITANCE		VP
	LIQUOR	R	BANK INTEREST		P
	VEHICLES	VP	REAL ESTATE:	URBAN DWELLINGS	P
	SERVICES	SP		AGRICULTURAL	VP
	STAMP TAX	P	SOCIAL SECURITY:		
	BUSINESS LICENCES	VP	PERSONAL CONTRIBUTION		SR
IMPORT DUTIES		R	EMPLOYER'S CONTRIBUTION		R

Source: Oscar Altimir and Mattia Barbera, "Tributación y equidad en América Latina. Un ejercicio de evaluación cuantitativa", Santiago, Chile, ECLAC, October 1991 (unpublished).

^a The fiscal indicator given below was formulated in order to show the tax burden differential between the two richest deciles of the population and the four poorest. The sum of the product of the differentials for each tax with respect to its effective value in each country makes it possible to quantify the amount of resources that a given tax burden and structure can redistribute from the poorest to the richest strata or vice versa. If it is assumed that fiscal expenditure is neutral in terms of redistribution, this indicator shows the redistributive tendency and potential of a given fiscal system. The symbol [1] indicates the formula used to calculate this indicator:

$$\Theta = \sum_{j=1}^n (\mu_j^{10} - \sigma_j^{10}) - \sum_{j=1}^n (\mu_j^4 - \sigma_j^4) \quad [1]$$

where:

μ_j^{10} = percentage of tax j collected in the two richest deciles.

μ_j^4 = percentage of tax j collected in the four poorest deciles.

σ_j^{10} = share of the two richest deciles in total income.

σ_j^4 = share of the four poorest deciles in total income.

b VP = very progressive: $\Theta > 0.40$;

P = progressive: $0.08 < \Theta < 0.10$;

SP = slightly progressive: $0 < \Theta < 0.08$;

SR = slightly regressive: $-0.08 < \Theta < 0$;

R = regressive: $-0.40 < \Theta < -0.08$.

Table IV-2

LATIN AMERICA: ESTIMATED REDISTRIBUTIVE CAPACITY OF SOME SELECTED TAX SYSTEMS *				
COUNTRY	YEARS	AVERAGE REDISTRIBUTION PER TAX UNIT	IMPLICIT TOTAL REDISTRIBUTION	TAX BURDEN WITH ESTIMATED INCIDENCE
			(% GDP)	(% GDP)
ARGENTINA	1982	0.06	0.7	13
	1987	0.09	1.2	14
	1988	0.07	0.8	12
BRAZIL	1980	0.08	1.3	16
	1988	0.10	1.4	14
COLOMBIA	1977	0.23	1.9	8
	1981	0.17	1.4	9
	1987	0.19	1.9	10
COSTA RICA	1979	0.07	0.7	10
	1983	0.11	1.4	13
	1989	0.05	0.7	12
CHILE	1975	0.09	2.0	22
	1980	0.06	1.2	20
	1986	-0.02	-0.4	20
MEXICO	1975	0.17	1.9	11
	1980	0.29	3.3	12
	1989	0.25	3.1	12
URUGUAY	1980	0.03	0.4	13
	1988	0.01	0.2	14

Source: Oscar Altamir and Mattia Barbera, "Tributación y equidad en América Latina. Un ejercicio de evaluación cuantitativa", Santiago, Chile, ECLAC, October 1991 (unpublished).

* Estimated redistributive capacity of the tax systems of seven Latin American countries. The table indicates: i) the average redistribution per tax unit, which, if positive, indicates the amount of each additional tax unit which, with a given tax system, would be redistributed from rich to poor; ii) the implicit total redistribution, which, if positive, indicates the percentage of the gross domestic product which a given tax system redistributes during a year from rich to poor; and iii) the tax burden, whose incidence has been estimated in this exercise as a percentage of the gross domestic product.

Table IV-3
COMPARISON OF FISCAL BURDEN OF LATIN AMERICAN COUNTRIES, OECD MEMBERS AND NEWLY
INDUSTRIALIZED COUNTRIES
(Average for period 1987-1989 as a percentage of GDP)

Countries	Total fiscal burden	Social security burden	Tax burden ^a	Indirect tax burden ^b
OECD				
Sweden	56	14	42	24
France	44	19	25	8
Germany	38	14	24	13
Italy	37	12	25	13
United Kingdom	37	7	30	14
Spain	33	12	22	10
United States	30	9	21	13
Southeast Asia				
Singapore	29	0	15	8 ^c
Malaysia	25	0	17	8
Korea	19	1	16	6
Indonesia	18	0	15	10 ^c
Thailand	17	0	15	4
Philippines	13	0	12	3 ^c
Latin America				
Chile	25	2	20	3
Costa Rica	25	7	16	3 ^d
Uruguay	25	7	16	3 ^d
Argentina	23	4	17	3 ^d
Ecuador	23	3	16	3 ^d
Mexico	22	2	18	5
Colombia	22	1	13	4
Brazil	21	4	14	4
Venezuela	21	1	16	3 ^d
Bolivia	19	3	16	1 ^d
Paraguay	10	2	8	2
Peru	9 ^c	1	8	2 ^d
Guatemala	9	nd	8	2 ^d

Source: Members of the Organization for Economic Cooperation and Development (OECD), Revenue Statistics of OECD Member Countries, 1965-1990, Paris, 1991. Latin American countries: ECLAC/UNDP Regional Fiscal Policy Project. Southeast Asian countries: International Monetary Fund (IMF), Government Financial Statistics Yearbook, 1990, Washington, D.C., 1990.

^a Excluding social security and non-tax income. ^b In the case of the OECD countries, includes personal income tax and corporate income tax. For the Latin American countries, includes all direct taxes except those paid by public enterprises. ^c In the period 1985-1986, the total fiscal burden was 18% of GDP. ^d 1987. ^e Average for period 1987-1988.

possibility of establishing more progressive tax systems but also the economic and political viability of increasing the direct tax burden in a context of competitive developing economies. In fact, the direct tax burden in the region is only half that of the South-East Asian countries (representing 3.5 percentage points less of the gross domestic product) and only a quarter that of the OECD countries (that is to say, 10 percentage points less of the gross domestic product than in the latter) (see table IV-3).

To sum up, comparisons at the international level indicate that there is substantial leeway for raising the tax burden in various countries of the region, as well as modifying its structure, without significantly affecting collective well-being nor international competitiveness.

b) *Improving the equity of the tax structure*

Indirect taxes are regressive, or at best much less progressive than direct taxes, since in the final analysis they hit poorer households much harder than those with greater resources. In spite of the theoretical and practical difficulties involved in analysing the different degrees of incidence of the different types of taxes, the few studies available in the region reveal that: i) most direct taxes (on income, wealth, inheritance and capital gains) are highly progressive, ii) that the Value Added Tax (VAT) is slightly progressive when essential consumer goods are exempted from it³ and regressive when it is generalized, and iii) most of the other indirect taxes (made up of special taxes and import duties) are regressive (see tables IV-1 and IV-2).

Unlike the industrialized countries, where—as for example in France—direct taxation is at the rate of a minimum of 8% and often closer to 13% of the product, accounting for between one-third and more than half of the tax burden, most of the countries of Latin America have a direct burden—excluding appropriation of rents from State exports—of between 2% and 4% of the product, generally representing between one-

fifth and a quarter of the tax burden (see table IV-3).

These tax structures are biased in favour of less progressive taxes, and in some cases in favour of the most regressive ones, and when their differential influence on the different income groups is taken into account they do little to improve equity in the distribution of well-being. At the end of the 1980s, the estimated capacity of the different tax structures of the Latin American countries to redistribute real income—through the differential incidence of the mix of taxes in each country on the 20% richest households and the 40% poorest—did not amount to even 10 cents of each peso of tax in most of the countries: indeed, it was almost zero in Chile and Uruguay, and it only came close to or exceeded 20 cents per peso in Colombia and Mexico (see table IV-2).

If this redistributive capacity of the tax structures is combined with the respective tax burdens, then the implicit redistribution comes to over 3% of the product in Mexico from 1980 onwards and almost 2% in Colombia; but it is more often lower (less than 1.5% in Brazil, or 1% in Argentina in 1988 and in Costa Rica in 1989), while in some countries it is virtually insignificant (Chile in 1986 and Uruguay in 1988).

In these circumstances, there are two supplementary criteria for ensuring that tax reforms are reflected in more progressive systems. On the one hand, measures should be taken to promote an improvement in the structure of indirect taxes, particularly through the replacement of specific taxes on mass consumption products by a Value Added Tax (with the fewest possible exceptions) and the application of specific taxes on the consumption of articles preferentially used by the upper income strata (it may be recalled, for example, that taxes on motor vehicles are highly progressive) or on the consumption of articles with a non-regressive incidence (for example, taxes on fuels are usually neutral or rather progressive).

At the same time, a greater effort should be made to raise the levels of direct taxation, which

are comparatively low. This could involve, according to the particular cases, higher rates, a broader base of types of income and taxpayers affected by the tax, fewer exemptions (except for persons of low income), the reduction of tax evasion, and other similar measures.

c) *The feasibility of tax reforms aimed at improving equity*

Tax reforms which seek to improve equity by increasing the tax burden and securing greater progressiveness in the tax structure undoubtedly mean increased production costs or lower return on capital. They are therefore usually resisted because they are considered to discourage private investment, adversely affect international competitiveness, encourage the flight of national capital, promote tax evasion, and lower the political feasibility of the reform.

These arguments, which are the ones usually put forward, become less impressive when they are viewed in terms of current Latin American conditions. On the one hand, an increase in the tax burden which helps to reduce the fiscal deficit (and hence also inflation) will not necessarily increase the total effective burden (which includes the inflation tax). On the other hand, to the extent that the bigger tax revenue helps to finance increased investment in "human capital" (education, training, health, etc.), it will raise productivity and hence the profitability of capital, which may well offset the drop in the return on capital due to higher taxation. Indeed, seeking to base international competitiveness on the current low rates of direct taxation is no more logical than basing it on low real wages;⁴ in reality, both of them represent only temporary advantages which must eventually be replaced by increases in productivity due to technical progress and investment in human capital, giving rise to an increase in real wages and in the direct tax burden.

Nevertheless, political resistance to progressive tax reform may bring it to nothing. Similarly, tax evasion may cause the reform to fail by reducing the effective tax burden and

thus affecting equity. Overcoming the first-named of these problems calls for a "fiscal pact" regarding the objectives, strategy and comparative advantages of the reform. Even rigorous tax legislation can be put into effect through such consensus for this is a fertile and as yet insufficiently explored field where, despite the obstacles, some countries have made significant achievements.

Among the recommendations which have been made in other ECLAC documents in this respect, mention may be made once again of the importance of the following: the existence of political support at the highest level; the maintenance of severe legislation on control measures and punishments in respect of tax offences; exemplary punishment of individuals or companies who are guilty of serious evasion, in order to show that no exceptions will be permitted; the payment of better salaries to tax inspectors and the application of drastic penalties to those who accept bribes; the simplification of tax legislation and the elimination of most special deductions and exemptions, and finally, the massive checking of taxpayers through computerized spot checks, since this impersonal and automatic procedure guarantees equal and non-discretionary treatment to all taxpayers (see box IV-1).

4. The restructuring of public expenditure

In most of the countries of the region, public expenditure has been the main variable affected by the fiscal adjustment process aimed at coping with the turnaround in the net external resource flow suffered by the Latin American countries in the 1980s and eliminating the inflationary pressures exerted by the public deficit. Only a very few countries have recovered their previous real level of total public spending after payment of interest on the public debt; others have lowered it by between 20% and 30% compared with the pre-crisis levels. Consequently, in most of the countries per capita social expenditure has gone down markedly during the decade (see table IV-4).

Box IV-1

THE CAMPAIGN AGAINST TAX EVASION IN CHILE

In 1977, a major campaign was begun against tax evasion in Chile, its main result being that four years later tax revenue had risen by between 22% and 35% compared with the growth of the product over the same period. The central elements of this campaign were the following:

1. Political support at the highest level

The key factor in the effectiveness of this campaign was the generation of a firm belief among the population and the tax inspectors themselves that no evasion or bribery would be tolerated nor would any exceptions be made, no matter who they concerned. An event which helped to generate credibility among the inspectors was that soon after the beginning of the campaign one of the highest officials of the Internal Revenue Service was dismissed on suspicion of taking bribes (because he had a standard of living much higher than his salary would have permitted him), even though he was a supporter of the regime and enjoyed recommendations from high political figures in it. The same message was communicated to the population when the commercial establishment of a person related to a high government personality was closed for selling goods without giving the corresponding sales receipt stamped by the Internal Revenue Service, which was the control mechanism established in order to check on the payment of the Value Added Tax.

2. Heavier and more effective penalties for tax evasion

The fines and penalties for tax evasion were increased, while at the same time the discretionary powers of the Internal Revenue Service to apply such penalties were also expanded. In view of the absence of opposing interests between buyers and sellers in the last link of the Value Added Tax chain —i.e., the final sale to the consumer— fines and compulsory closure of businesses (normally for between 10 and 20 days) were established as the penalty for failure to issue sales receipts. This turned out to be a powerful weapon and was extensively used. Finally, a waybill duly stamped by the Internal Revenue Service was required for all transport of goods, failure to comply being punished with the same penalties as failure to issue sales receipts.

3. Control by computer

This is considered to be the most significant technical innovation in the control system. It made it possible to detect evasion of Value Added Tax rapidly and cheaply by comparing the debits/credits (or sales/purchases) ratio of each enterprise with the average for enterprises of the same sector, scale, region, etc. All unusual cases were then inspected on the spot. This system also made it possible to check disparities between different declarations (for example, firms requesting credit for Value Added Tax paid but not declaring income tax) or between different taxpayers (every effort was made to ensure that invoices presented as fiscal credit by the purchasing enterprise had been entered in the accounts as debits by the seller company for the same amount). This system also made it easier to compare information on expenditure obtained from other sources (purchase of a house, motor vehicle or shares) with income tax declarations.

4. Publicity campaigns

Every tax control campaign (payment of Value Added Tax, checking of income tax declarations, checking of waybills on the highways) was accompanied by a publicity campaign whose central message was that it was best to avoid problems with the Internal Revenue Service. Likewise, although there was a certain degree of simulation in this, every control campaign was accompanied by the sending out of warnings of impending checks of this type to a large number of taxpayers, thereby establishing a high degree of credibility in the Internal Revenue Service's actions.

Box IV-1 (concl.)

5. Reorganization of the Internal Revenue Service

The process of control by the Internal Revenue Service was centralized in the capitals of the twelve administrative regions of the country and the inspectors were rotated within each region every two years in order to prevent them from establishing excessively close contact with the taxpayers and thus reduce the temptation to take bribes or to be excessively tolerant.

Finally, the entry requirements for new inspectors were raised and they were now required to have a university degree, while the existing staff were subjected to a simple examination on the knowledge of the laws and regulations they have to apply, and those who failed had to leave the service, as did those chiefs whose competence or conduct were not of a level compatible with their functions. The total staff was thus reduced from 3 900 to 2 000 officials, but the salaries of those who remained were raised by more than 80% in real terms until the 1982-1983 crisis occurred, after which their wages were adjusted in the same way as in the rest of the public sector.

6. Necessary preconditions

The campaign against tax evasion was begun only after the completion of the 1975 tax reform, which greatly simplified the tax system as far as tax administration was concerned: i) the tax rates for all taxpayers of similar characteristics were unified. Before the reform there was a "general" rate of 17% for enterprises, but this was increased to 35% for joint stock companies and to 40% for banks, whereas professionals paid tax at the rate of 7% and associations of professionals paid 12%; ii) almost all the existing exemptions, the list of which occupied 164 pages, were eliminated, and iii) a sales tax at rates which varied from 8% to 24%, with 108 exemptions listed in the respective Act itself, plus 173 additional legal texts referring to a similar number of exemptions, was replaced with a Value Added Tax at a single rate of 20%, applicable to virtually all goods and services.

Clearly, such an important advance in tax administration would not have been possible without relatively simple laws and a minimum of exemptions. In fact, the tax reform facilitated not only proper compliance by the taxpayers, but also effective and massive control through relatively simple computer programmes.

Source: See C. Eyzaguirre, "Resumen de la experiencia de control de la evasión tributaria en Chile, 1977-81", Santiago, Chile, 1985 (mimeo).

Consequently, the effort to secure greater equity through social expenditure means that the level of such expenditure must be restored and raised as soon as increases are generated in fiscal income, especially in those countries where per capita social spending went down significantly during the past decade. As it will take some time to increase fiscal income sufficiently to attain adequate levels of social expenditure, those efforts must meanwhile be supplemented with others in at least two further aspects: the reallocation of public expenditure towards the social areas, channeling proportionately more services to the neediest groups, and the improvement of the effectiveness and equity of social spending so as to provide more or better services with the same amount of resources.

a) *Reallocation of public expenditure to the social areas*

In other parts of this chapter, consideration is given to alternative means of mobilizing resources to raise public expenditure and thereby make possible the expansion of social expenditure. This is therefore a suitable point to consider the alternatives for reallocating resources from other functions to social expenditure, while maintaining a given level of total public spending, in addition to the possibilities of assigning any increase in public resources directly to increased social spending.

The reallocation of expenditure towards the social areas presupposes that the other areas of public expenditure affected by the reallocation will retain sufficient technical, legal and political

Table IV-4

LATIN AMERICA: PUBLIC SPENDING AND SOCIAL EXPENDITURE
(As percentages of GDP)

Country	Year	Total public spending	Interest	Total spending without interest	Social security	Social expenditure ^a Housing	Remainder	Deficit	Per capita social expenditure 1982-1985 1986-1988
									(Indexes, base 1979-81 = 100)
Argentina ^b	1989	32.8	5.3	27.5	5.2 ^c	4.1 ^c	5.8 ^c	8.8	85.5 ^c
Bolivia	1987	26.1	4.7	21.4	2.0	0.1	4.3	8.5	75.5
Brazil ^d	1988	31.2	6.3	24.9	5.1	10.7	4.0 ^d	7.4	97.2 ^d
Colombia	1989	23.8	3.7	20.2	2.0	nd	nd	2.2	nd
Costa Rica	1989	36.4	6.4	30.0	7.4	1.1	8.1	-0.5	83.1
Chile ^b	1989	36.3	6.6	29.7	7.1 ^e	3.0 ^e	5.2 ^e	0.8	108.8
Ecuador	1987	29.2	3.9	25.4	nd	0.2	5.9	4.4	91.0
Guatemala	1987	11.8	1.4	10.4	nd	0.3	3.6	2.5	60.6
Mexico	1989	31.1	13.0	18.1	2.1 ^e	0.1 ^e	3.1 ^e	5.4	88.2
Paraguay	1988	14.6	1.4	13.2	1.3 ⁱ	0.2 ⁱ	2.2 ⁱ	2.4	129.3
Peru	1989	13.2	1.7	11.5	nd	nd	nd	5.5	nd
Uruguay	1987	28.0	2.5	25.5	9.5	0.1	5.5	0.7	97.5
Venezuela	1987	27.0	4.2	22.9	1.6 ^h	0.9 ^h	7.5 ^h	3.4	90.6
									85.5

Source: ECLAC, on the basis of official figures and IMF data.

^a Includes spending and net loans by the central government in the areas of education, health, social security/social assistance, housing/community services, and recreation/culture/religion.
^b General government. Does not include social loans by quasi-autonomous bodies.
^c 1987.

^d Does not include expenditure on housing, nor expenditure on education and health by States and municipalities, which amount to substantial sums (between 1984 and 1986 these probably came to around 1.9% and 0.5% of GDP, respectively). Source: IBGE/DEASP and IMF.

^e 1988.

^f 1987. Base 1981 = 100.

^g Base 1979 = 100.

^h 1986.

ⁱ 1987. Does not include net loans.

capacity to permit their continued functioning in accordance with their basic responsibilities. In this respect, it is important to recall that current public spending often suffers from rigidity over time, because between 70% and 90% of the expenditure programmed for a year is determined by the expenditure during the previous year. This tends to reduce the practical potential of this alternative, especially after several years of repeated substantial budget reductions in both current and capital expenditure in almost all areas of public expenditure.

Nevertheless, the process of restructuring of the public sector itself involves a redefinition of priorities which means changes in the structure of total expenditure. A first item which could generate additional resources is that of interest payments, which will go down in line with the process of debt conversion. Even if interest payments are excluded from consideration of public spending, however, there are other particularly promising areas which could provide possible savings that could be used for higher expenditure on social programmes.

One of these areas, which has been mentioned by a number of sources⁵ is related with military expenditure. This would represent the regional expression of the potential which exists in the whole world for reducing arms and defence spending in the light of the new conditions emerging as a result of the end of the Cold War. Although Latin America is not one of the regions where military spending represents a very high proportion of the gross domestic product, there is undoubtedly substantial potential in a number of countries for reducing this coefficient. In this respect, defence spending continues to be high compared with the resources devoted to education and health in various countries of the region (see table IV-5).

Another area of potential saving is connected with the gradual elimination of functions which are superfluous now that the State is moving more towards regulation than direct control, and the elimination of projects of

low priority or low social profitability from public investment programmes.

b) *Improvement of the efficacy and equity of social expenditure*

At all events, the possibilities for reorganizing expenditure seem to be rather limited compared with those offered by raising revenue collection or improving the efficacy of the supply of social services. Attaining greater efficiency in social spending has, at least in conceptual terms, two consequences: the first of these is to increase the cost-effectiveness of spending while maintaining its present structure, and the second is to channel the spending more directly towards the poorest members of the community. The first of these represents an improvement in services in terms of quantity or quality, whatever the total amount of the resources. The second, in contrast, means improving the targeting of the spending to favour the sectors with the lowest income or the worst living conditions. Public policy reform must obviously advance simultaneously in both directions, but this does not prevent some reforms from being relatively more effective in one direction than in the other.

The increase in cost-effectiveness seeks to raise the productivity of the resources assigned to the social sector in the public budget. In many cases, this means counteracting the entropic tendencies —partly attributable to cultural, institutional, organizational and/or management factors— which prevent proper use of the resources already available because of a lack of priorities, unsuitable "targeting" or inefficient administrative management (see box IV-2). In other cases, it is a question of overcoming certain problems deriving from the obsolescence of equipment (due in turn to the decline in investment) or the increasingly marked shortcomings in respect of the human resources at the service of the State, caused by the crisis and the lack of a suitable human resources policy for public servants. Rationalizing the system and reducing its "leakages" not only

Table IV-5

MILITARY SPENDING AND SOCIAL EXPENDITURE, 1986

Countries	Military spending (% GDP)	Military spending/educa- tion plus health (%)	Armed forces	
			Per 1 000 inhabitants	As % of number of teachers
Industrialized countries				
United States	6.7	37	8.6	100
United Kingdom	5.0	45	5.7	62
France	3.9	26	9.9	113
Netherlands	3.1	20	6.8	94
Germany	3.1	24	8.6	99
Sweden	2.9	18	7.7	92
Italy	2.3	21	6.7	85
Spain	2.3	25	8.3	125
Japan	1.0	8	2.0	25
Developing countries				
Korea	5.2	153	14.0	272
Morocco	5.1	86	6.8	102
Zimbabwe	5.0	44	4.3	59
Turkey	4.9	148	11.7	271
South Africa	3.9	75	3.0	32
India	3.5	81	1.5	28
Indonesia	2.5	83	1.5	17
Algeria	1.9	23	6.8	71
Kenya	1.2	15	0.6	10
Nigeria	1.0	63	0.9	30

Table IV-5 (concl.)

Countries	Military spending (% GDP)	Military spending/educa- tion plus health (%)	Armed forces	
			Per 1 000 inhabitants	As % of number of teachers
Latin America and the Caribbean				
Cuba	7.4	79	15.3	106
Peru	6.5	217	5.9	86
El Salvador	3.7	137	8.2	183
Chile	3.6	59	7.7	108
Panama	2.0	18	5.0	50
Ecuador	1.6	30	4.0	46
Venezuela	1.6	25	2.5	28
Uruguay	1.6	17	10.3	107
Jamaica	1.5	18	0.8	20
Argentina	1.5	31	2.3	50
Dominican Republic	1.4	47	2.9	58
Paraguay	1.0	83	3.7	49
Colombia	1.0	28	2.0	34
Brazil	0.9	16	1.9	24
Mexico	0.6	13	1.6	17
Costa Rica	0.0	0	0.0	0

Source: Prepared on the basis of figures from United Nations Development Programme (UNDP), Human Development Report, 1991, Bogotá, Tercer Mundo Editores, 1991.

Box IV-2

LIMITATIONS OF SOCIAL EXPENDITURE POLICIES

a) Segmented access

Many State social services have restricted their coverage to limited segments of the population. At certain points in time, very varied corporative groups succeeded in obtaining concessions from the Government which gave them the right to receive benefits from which needier groups were excluded or were only admitted much later. This was particularly so in the case of social security, which even now has not yet incorporated landless peasants or own-account urban workers. The generally tripartite form of financing used involves a State subsidy which is not distributed in accordance with the needs of the beneficiaries but rather the capacity of each group to exert pressure.

b) Exclusive universalism

In many cases, the law guarantees the right of all persons to receive equal attention from the public services. In practice, however, it is precisely the poorest who cannot gain access to such benefits. Education is a critical case in point, since the lack of access to this service helps to reproduce the vicious circle of poverty. For example, the law speaks of primary education which is free and even compulsory, but as the poorest families cannot cope with the indirect or opportunity costs of education, they end up by withdrawing their children from the schools even though the State assumes the direct costs of education.

c) Regressiveness

Many social programmes help to increase inequalities, of which relatively privileged social groups then take advantage. Redistributive social programmes could enhance their social effect if they were improved so as to reduce such distortions. In Latin America, training a single university graduate costs as much as educating ten primary school children. It would clearly be more equitable to concentrate public spending on expanding and improving basic education, while setting up systems of credit in order to enable low-income students to complete higher studies but charging the real cost of their university education to the other students.

d) Inertia or discontinuity

There is always some resistance to the reorientation of social policy. It is very difficult to suspend programmes, even where there is ample evidence of their ineffectiveness or inefficiency. Such changes are resisted both by the members of the bureaucracy responsible for running them and by the clientele which takes advantage of them.

There is also a defect which operates in the opposite sense, however. Thus, the discontinuity of social policies means that initiatives may be cut off even before their results can be evaluated. Sometimes, a change of government leads to the introduction of fresh priorities and the abandonment of programmes which need more time to bring results.

e) Proliferation of issues and institutional fragmentation

New social issues are constantly appearing on the agendas of governments. All of them are said to be important; all of them demand attention, resources, and administrative capacity. The result is unsatisfactory for every one of the issues, thus helping to reduce the effects on beneficiaries. In other words, there is a lack of clear and well-defined criteria for assigning priorities.

Certain activities demand a minimum acceptable level of efforts and resources, below which there can be no results and the resources will be wasted.

Likewise, the continual establishment of new institutions tends to result in conflicts of competence among the various institutions; they squabble over resources and fields of action and act in an uncoordinated manner, thereby reducing the effectiveness of the social expenditure.

offers an additional means of expanding social spending but also represents a crucial step forward towards the attainment, in the area of public administration, of the patterns of rationality which are essential for the functioning of a modern State.

Some of the reforms which can significantly improve the effectiveness of social spending, in different combinations of cost-effectiveness and improvement of equity, are listed below:

i) *Ensuring adequate complementarity of key resources in the provision of services.* In this respect it may be noted that bottlenecks are often created and the effectiveness of many programmes is significantly reduced because they do not take sufficient account of the need to maintain a suitable balance in the use of key complementary inputs. For instance, there are often imbalances in the relative proportions of staff, as for example between doctors and paramedical personnel, or there is a lack of basic infrastructure, as in the case of teachers who do not have the minimum necessary teaching material, or primary health posts which do not have water or electricity; or there are imbalances between current expenditure and investment or between investment and maintenance expenditure; or there is a tendency to misuse costly services, such as the emergency services in hospitals, because of the deterioration or absence of other essential health services.

ii) *Elimination or reduction of subsidies which are clearly not linked with the needs of the poorest families.* In this respect, mention may be made of the direct monetary transfers or the provision of various fiscal incentives to enterprises under old legal provisions designed to favour infant industries or under the industrial policy in general.

iii) *Assignment of subsidies to particular groups on a priority basis.*⁶ Examples of this are the distribution of school lunches to children attending the public school system in the poorest areas, rather than providing a general subsidy on

food; or the distribution of transport passes to school children within certain age limits, on week days and within certain times of day, instead of giving a general subsidy to urban transport. Likewise, with regard to the problem of the improper allocation of benefits within a given sector, it may be noted that two of the most important errors are usually the following:

a. *In the area of health*, it is extremely questionable to channel most of the sectoral expenditure to curative medicine, which is often administered by expensive hospital complexes, frequently located in urban areas far from the dwelling places of the masses of low-income inhabitants. In Brazil, for example, it is estimated that approximately 80% of all health expenditure goes to curative medicine, and only the remaining 20% to all the other activities, including preventive measures with regard to mother and child health programmes, control of infectious diseases, immunization programmes of various types, and other activities which, as well as being more cost-effective in reducing mortality and morbidity, have the advantage of serving the needs of the lower income groups more directly.⁷

b. *In the area of education*, it is necessary to review the allocation of large amounts of resources to university education, to the detriment of basic education and technical and professional secondary education. Although there is evidence that in Latin America the social return on university education is clearly positive, there is no doubt that in the area of primary and secondary education it is even higher. In addition to the efficiency dimension involved in the foregoing argument, emphasis should be placed here on the favourable contribution to the dimension of equity made by the allocation of additional resources to primary and secondary education, especially in countries with high rates of illiteracy. In some Latin American countries, higher education absorbs more than twice as much of the spending on education as secondary education: figures which it is very interesting to compare with those of Korea, where higher education absorbs less than

one-third of the expenditure on secondary education.⁸

The two types of "errors" referred to above are very difficult to solve, since they involve the functioning of activities where there are powerful vested interests at work. Problems of this type are also responsible, at least in part, for the "rigidity" or "inflexibility" of public spending.

iv) *Ensuring that subsidies reach their legitimate beneficiaries as efficiently as possible.* This can be achieved, for example, by preventing subsidized lines of credit designed to help low-income groups to buy their own houses from being used by people in higher economic strata and also making sure that the subsidized credit is not used for the purchase of second or third-hand houses, which, when there is sudden rise in demand, often register price rises which provide windfall gains for their owners.

5. Other ways of raising income and reducing public expenditure

The restructuring of public enterprises has a potentially important role to play in the area of public finances in so far as it frees or generates additional fiscal resources which can be used to finance public policies aimed at furthering greater equity. The main options available are the restructuring of such enterprises, their maintenance as State property, or their sale and privatization.⁹

The crisis of the 1980s and the need to control and reduce the high overall public sector deficit forced the public enterprises to make severe adjustments during the decade. Thanks to these adjustments —especially those which enabled pricing policies to be brought more in line with the opportunity costs of the factors involved— there was a substantial improvement in their financial performance. Thus, between the periods 1980-1981 and 1986-1987 (the last years for which comparable data are available for a significant number of countries), the number of countries with a significant global

deficit for their public enterprises went down from four in the first period to two —Argentina and Brazil— in the second. Likewise, between 1986 and 1987 the average surplus of the nine countries for which comparable information is available came to the equivalent of 2.6% of the gross domestic product, or 1% if Venezuela and the Mexican and Ecuadorian oil companies are excluded (see table IV-6). Consequently, the resources freed between the two periods in question amounted, on average, to the equivalent of 1.4% of the gross domestic product in the case of the group of nine countries mentioned in the first place (and 2% in the case of those in the second group).

Although generally speaking this reorganization of public enterprises was not reflected in an increase in social expenditure, at all events it indirectly helped to improve income distribution, since the reduction in the fiscal imbalance helped to stabilize the economy and reduce the inflation tax, which, as noted in the previous chapter, hits the lower-income groups relatively harder.

Furthermore, in the early 1980s there was also a growing trend towards the sale and privatization of public enterprises. Privatization generates resources for the State through the capitalization of the net future income of the enterprise. It should also be noted that these resources have been by no means insignificant in amount. In Chile, for example, they came to 1.3% of the gross domestic product during the period 1985-1989; in Mexico, to 0.2% between 1982 and 1988 and 1.2% in the two-year period 1989-1990; and in Argentina, to 1.7% in 1990, which was the year in which the privatization process began. However, apart from the flow of future tax revenue, privatization basically generates resources at the moment when the sale price of the enterprises is paid.

Consequently, determining whether privatization is a good idea or not depends primarily on the sale price and, ultimately, the annual resource flow to which it is equivalent, including probable future tax revenue. There are two basic reference values which must be taken into account in deciding on the sale: the flow of

Table IV-6

LATIN AMERICA: SAVING AND DEFICIT OF PUBLIC ENTERPRISES,
1980-1981 AND 1986-1987
(Percentages of GDP)

Country	D 1980-1981 (1)	D 1986-1987 (2)	D* 1980-1981 (3)	D* 1986-1987 (4)	Absolute va- riation in D* (5)=(4)-(3)
Argentina	-3.39	0.59	-4.92	-2.75	2.17
Bolivia	0.10	-2.90	3.65	7.95	4.30
Brazil	-1.69	0.10	-3.10	-2.10	1.00
Chile ^a	-1.33	0.78	5.47	10.33	4.86
- Excluding CODELCO ^b	-	-	-	-	-
Colombia	-2.00	-1.41	-3.16	0.08	3.24
Costa Rica	-2.37	0.97	-1.55	3.46	5.01
Ecuador	-0.63	-1.77	4.60	4.09	-0.51
Non-oil- exporters	(-1.6)	(-0.55)	(-1.92)	(-0.67)	(1.25)
Mexico	-1.30	0.25	1.49	4.62	3.13
Non-oil- exporters	(-1.57)	(-0.26)	(-6.22)	(-4.97)	(1.25)
Uruguay	0.26	0.10	2.69	3.14	0.45
Venezuela	-2.33	-2.62	11.08	5.16	-5.92
Total ^c	-1.48	-0.74	1.20	2.63	1.43
Subtotal ^d	-1.14	-0.32	-0.80	1.22	2.02

Source: ECLAC, on the basis of official figures.

Note: The signs used in this table are the following:

D = Total income less total expenditure.

D* = D - T (T = transfers with the central government, registered in its accounts).

^a For the period 1986-1987, the values used were those for 1985, which is the last year for which figures are available.

^b CODELCO = Chilean Copper Corporation, a State enterprise.

^c Simple average, excluding Chile.

^d Simple average excluding Chile, Venezuela, and the petroleum enterprises of Ecuador and Mexico.

income currently generated for the State by the public enterprise, and the flow of income which it will bring to its new owners when it is privatized. For the State, the main objective in the auction process is to secure the highest possible sale price without adversely affecting the quality and efficiency of the service provided or the minimum social objectives which correspond to public services. Thus, the objective must be to obtain a price which is not only higher than the value this asset had for the State, but also to obtain a price which is as close as possible to the value it has for its new *private owners*, so as to secure for the State the bulk of the possible increase in productivity deriving from its sale. This raises various requisites: to ensure the largest possible number of potential buyers in the auction, which must be carried out in the most open and transparent manner possible, prohibiting *inter alia* offers from groups connected with the management of the State enterprise; as far as possible, to sell the enterprise once it has been restructured, and above all, not before correcting its scale of charges; to sell the enterprise preferably at a time of expansion, with interest rates close to their long-term values, and above all to avoid selling in the middle of a recession; to liberalize the market in which the enterprise to be sold operates *before* the sale, and —if it is a natural monopoly— to establish a clear framework of public regulation before beginning the privatization process.

Experience indicates that in the sale of public enterprises there is an ever-present risk of undervaluation. In studies made in countries with long experience in privatization —such as the United Kingdom, France and Chile— it has been found that the prices obtained (excluding the costs of the transaction) were on average 15 to 30% below the commercial value of the enterprise.¹⁰ Fixing the correct price of an enterprise is clearly a difficult task and is open to legitimate debate. Nevertheless, in addition to the considerations mentioned above, some procedures are particularly

important in order to reduce the risk of undervaluation:

i) *Plan the sale carefully.* In contrast with popular wisdom, the best privatization is not necessarily that which is carried out in the shortest possible time. In order to obtain a good sale and secure a substantial part of the benefits of greater efficiency, judicious preparation of the tender invitations is necessary in order to ensure that the tender process is as competitive as possible. Since fixing the "correct" price is often a process of trial and error, the progressive sale of limited "packages" of stock giving control of the enterprise might be considered appropriate. A strategy of this type would make it possible to get the feel of the market, correct errors and take advantage of any subsequent increase in the value of the remaining package of shares. A staggered process of sale may also be advisable when there is a large number of enterprises or shares to be privatized or when the national economy is going through a phase of recession.

ii) *Reform scales of charges and reorganize the enterprise before it is sold and privatized.* In view of the serious inefficiency of some enterprises, it is very likely that some microeconomic reforms and corrections of scales of charges may be advisable before their sale. These reforms would enable the State to incorporate before the sale some of the benefits brought by greater future efficiency, thereby increasing the minimum market value of the enterprise. Furthermore, such reforms will probably be necessary in any case in order to reduce the risk perceived by the market, so as to increase the number of potential buyers. Improved viability of the public enterprise could also mean that the State might decide not to sell it at all, which would increase its bargaining power with the private sector.

iii) *Retaining a "gold share" for the State.* Since the estimation of the value of an important enterprise may be open to great uncertainty, the

possibility might be considered that the State might sell it on condition of retaining for itself a special share in the equity which would give it windfall dividends in the event that the future yield of the enterprise considerably exceeded the projections mutually agreed upon in the sale contract. In effect, the "gold share" would be a contingency instrument which would oblige both parties to share the risk between them. Although it could initially depress the sale price, it would at the same time give an option for subsequent recovery of that cost.

iv) *Sale to the highest bidder with a minimum of other considerations.* Particular caution should be exercised with regard to the strategy of so-called "popular capitalism", whereby the government authorities sell part or all of the shares in an enterprise *preferentially* to some specific groups, for although the deconcentration of share ownership is a desirable objective from various points of view, it also involves some problems, the main one of which is that it may reduce the sale price obtained by the State. Consequently, deconcentration should only be given preference as long as it does not have a serious effect on the price. It is also important to ensure that "popular capitalism" is not really a form of concealing the sale of shares on preferential terms to groups which are already privileged.¹¹

v) *Stipulate as clearly as possible the conditions in which the enterprise will operate.* In order to obtain a better price, it is important to reduce the uncertainty which may surround the future operations of an enterprise. What is important is not so much to define a "easy" regulatory framework, but rather one which is clearly defined, since uncertainty over future regulations on scales of charges, special taxes, special labour commitments or the possibility of making remittances of profits

and dividends abroad, etc., will cause those bidding for the enterprise to reduce their offers.

The importance of these procedures for securing a better sale price is illustrated in box IV-3, which compares the procedures and results of privatization processes in the telecommunications sector in three countries of the region. It will be noted that the countries have been learning from the privatization processes carried out.

Finally, another component which is of great significance in the fiscal accounts, and whose reduction would give greater flexibility to fiscal management, both for changing production patterns and for greater equity, is the servicing of the public external debt. The fact is that, either because the State originally contracted the debt or because after the outbreak of the crisis it was virtually forced to shoulder a significant portion of the private external debt, nearly 80% of the total external debt of the region is currently the responsibility of the public sector. This is why its servicing has had such a drastic incidence on the public finances, being largely responsible for the growing deficits registered in the decade and the consequent outbreaks of inflation and regressive effects.

For example, the average ratio of interest commitments to total fiscal income more than doubled for the main debtor countries between the periods 1980-1981 and 1983-1984, rising from 8% to 19%, which means that the mere *increase* in the debt servicing commitments of the public sector amounted to more than 2% of the gross domestic product (see table IV-7). Moreover, even after six years of adjustment, between 1988 and 1989 the interest on the external debt accounted for almost 16% of public sector income, attaining particularly burdensome levels in Ecuador (32%), Argentina (22%) and Venezuela (20%). This is why it is necessary to explore various formulas for reducing the weight of the debt service in the public finances: a process which is in fact already under way.

Box IV-3

SOME FORMS OF PRIVATIZATION IN THE TELECOMMUNICATIONS SECTOR

	Chile	Argentina	Mexico
Market structure before privatization	Vertical segmentation: one local monopoly and another for long-distance	Integrated monopoly	Integrated monopoly
Number of lines installed (millions)	0.6	3.2	4.3
Date of sale	January 1988	November 1990	December 1990
Statement of aims of privatization	No	Indirectly	Yes
Incorporation of workers into the process	No	No	Yes
Prior adoption of regulations	Yes	No	No
Total percentage of stock sold	49%	60%	20.4% (corresponds to 100% of voting stock)
Market structure after privatization	Vertical segmentation: one local monopoly and another for long-distance	Regional segmentation: one monopoly in the North and another in the South	Integrated monopoly
Duration of concession	Indefinite	7 years	50 years, renewable
Limitation on foreign capital	No	No	49% of the controlling package
Binding goals regarding expansion and quality	No	Yes	No
Equivalent price obtained (US\$ per line)	1 035	705	1 915

Source: ECLAC, *Información y telecomunicaciones: vector de la transformación productiva con equidad* (LC/R.1102), Santiago, Chile, December 1991.

Table IV-7

**LATIN AMERICA: INTEREST DUE ON PUBLIC EXTERNAL DEBT, AS A PERCENTAGE
OF GDP AND OF CURRENT INCOME OF THE NON-FINANCIAL
PUBLIC SECTOR**

Countries	1980-1981		1983-1984		1986-1987		1988-1989	
	GDP	Income	GDP	Income	GDP	Income	GDP	Income
In arrears								
Argentina	0.8	2.8	3.7	16.0	3.8	13.9	5.1	21.5
Bolivia	4.3	21.2	5.8	64.8	3.4	17.9	2.9	13.6
Brazil	1.7	7.2	2.6	11.1	2.2	8.8	1.9	8.5
Costa Rica	3.6	11.3	8.9	22.8	6.8	18.3	4.5	12.0
Ecuador	2.9	10.9	5.3	19.3	6.4	24.3	8.0	32.8
Peru	2.4	9.6	3.8	15.5	2.0	10.2	1.5	14.7
Subtotal ^a	2.6	10.5	5.0	24.9	4.1	15.6	4.0	17.2
Not in arrears								
Colombia	1.0	5.5	1.3	7.2	2.7	12.2	2.9	13.2
Chile	1.7	5.0	3.9	11.9	6.8	19.4	4.1	11.1
Mexico	1.8	8.4	4.5	17.0	4.7	19.4	3.7	14.7
Uruguay	1.1	4.1	4.5	17.4	3.7	13.2	3.2	11.9
Venezuela	2.0	5.6	2.7	8.2	3.3	13.1	4.3	20.0
Subtotal ^a	1.5	5.7	3.4	12.3	4.2	15.5	3.6	14.2
Total ^a	2.1	8.3	4.3	19.2	4.2	15.5	3.8	15.8

Source: ECLAC, on the basis of official figures.

^a Simple average.

Notes

¹ For example, the aim of the 1978 tax reform in Mexico was to spread the tax burden more equitably, to which end it was sought to change the tax structure rather than increasing the existing taxes. More specifically, the share of direct taxes was raised by expanding the tax base to include taxes on capital gains, rents, dividends, and non-financial income, as well as earned income. As a result, the tax system became much more progressive than it had been before (see table B of box IV-1). Thus, the tax pressure on the five lowest income deciles went down from an average of approximately 13% to less than 11%, while the pressure on the top two income deciles rose by around two percentage points. See F. Gil Díaz, "Some Lessons from Mexico's Tax Reform", *The Theory of Taxation for Developing Countries*, David Newberry and Nicholas Stern (editors), New York, Oxford University Press, 1987.

² It is perfectly justified to exclude tax collection for social security purposes from the comparison, since what we are interested in is determining the amount of resources which, in principle, are not specifically earmarked for a particular type of expenditure. However, the fact that the tax burden, net of social security, is substantially lower in the region than in the OECD countries, as also is the tax collection for social security purposes, means that the tax effort of the region is even lighter comparatively speaking than that of the OECD countries.

³ Although exemptions from VAT (or reduction of the rates applied) for essential consumer goods make this tax progressive, this progressiveness will be purely theoretical unless it is accompanied by an effective campaign against tax evasion, for experience in tax administration, especially in countries which do not have a long-standing tradition of compliance with the law, indicates that the greater the number of products enjoying exemptions or differential rates, the more difficult it will be to exercise proper tax control, and, consequently, the greater will be the probable tax evasion. Consequently, there should be few exceptions: they could be granted, for example, in respect of certain essential fresh foods which are difficult to control even when there are not differential rates of VAT, because they are generally sold in informal-sector markets.

⁴ The assumed discouragement of foreign investment is also open to question. On the one hand, both the direct tax burden and the marginal rates in the Latin American countries are usually well below those of the home countries of the transnational corporations. On the other hand, the competition among Third World countries to obtain these investments is determined more by natural resource rents, the relative cost of labour and the stability and prospects of progress of the country (including the improvement of social equity), than by moderate differences in taxation. Likewise, the capital flight in the region in the early 1980s was much more sensitive to macroeconomic and exchange stability and to the type of rules in force than to differences between tax rates among the countries.

⁵ United Nations Development Programme (UNDP), *Human Development Report 1991*, New York, Oxford University Press, 1991; Michel Camdessus, "Camdessus identifies IMF's priorities for transition period ahead", *IMF Survey*, Washington, D.C., 4 November 1991: text of the opening remarks delivered on October 15 to the Board of Governors of the IMF in Bangkok.

⁶ Although "targeting" is an evident indication that an attempt is being made to give priority to the neediest groups, it must be borne in mind that it is an expensive business to identify these groups precisely. It may therefore be preferable to expand the coverage—or even make it all-embracing in certain categories (such as the rural population)—if it is considered that these categories cover a large part of the neediest persons, or of groups whose needs are not much less than theirs. It is also necessary to take account of the way in which targeting will affect the groups next to the poor sectors which have been selected and whether it will give rise, because of the removal of protection, to fresh centres of poverty. A broader discussion of this issue is given in Ana Sojo, "Nature and selectiveness of social policy", *CEPAL Review*, No. 41 (LC/G.1631-P), Santiago, Chile, ECLAC, August 1990.

⁷ See Nancy Birdsall and Estelle James, *Efficiency and Equity in Social Spending: How and Why Governments Misbehave*, Policy, Research and External Affairs Working Papers series, No. 274, Washington, D.C., World Bank, 1990.

⁸ See A. Komenan, *Improving the Quality of Education*, Washington, D.C., World Bank, 1987.

⁹ There is a wide range of possibilities within the option of restructuring public enterprises, including giving State enterprises greater autonomy, subcontracting certain operations, entering into management contracts, joint ventures, etc., many of which contain substantial components of "privatization". At the same time, even when an enterprise is sold and privatized, this is usually done in accordance with a regulatory framework which means that the operation is not completely "private". For purposes of simplification, however, we shall refer to the two extreme situations in which the ownership is either public (restructuring) or private (privatization).

¹⁰ See, among others, John Vickers and George Yarrow, *Privatization: an Economic Analysis*, Cambridge, Massachusetts, MIT Press, 1988; R. Seth, "Distributional issues in privatization", *Federal Reserve Bank of New York Quarterly Review*, vol. 14, summer 1984; Mario Marcel,

La privatización de empresas públicas en Chile, 1985-88, Notas Técnicas series, No. 125, Santiago, Chile, Economic Research Corporation for Latin America (CIEPLAN), January 1989; and Enrique Errázuriz and Jacqueline Weinstein, *Capitalismo popular y privatización de empresas públicas*, Documentos de Trabajo series, No. 53, Santiago, Chile, Programa de Economía del Trabajo, Academia de Humanismo Cristiano, 1986.

¹¹ It may often be desirable to sell a "package" of shares to the employees of the enterprise on terms which offer them a *certain degree* of preference (possibly in exchange for their severance funds), in order to identify them more closely with the results of the enterprise and facilitate its rationalization and sale. Careful consideration must be given, however, to the costs involved in this approach in terms of the lower income to the State. In this respect, an alternative which is often preferable in order to overcome possible resistance by the workers to the privatization and rationalization of the enterprise consists of negotiating commitments for investment and expansion as a condition of the sale.

Chapter V

TECHNICAL PROGRESS AND INTERNATIONAL COMPETITIVENESS

1. Introduction

Different schools of thought and policy now agree that the economic future of the region depends upon the way in which it is incorporated in the international economy. This consensus is based on arguments of theory, history and practical application. As far as neoliberals thinking is concerned, this position rests on the principles of the orthodox theory of international trade and the way in which comparative advantages are viewed under that theory. Structuralists believe that liberalization is necessary since exportation —especially of non-traditional products— constitutes the natural step to take after establishing the industrial platform built in support of import substitution.

Moreover, present world economic trends towards globalization and accelerated technological change (see chapter II) indicate that comparative advantages will increasingly derive from advantages acquired through an effort to modernize and penetrate markets rather than from those accruing from static advantages based on natural resources or cheap labour. Thus it is argued that advantages related to incorporation into the international economy are "competitive" rather than comparative.

As ECLAC sees it, the goal of changing production patterns is furthered by the deliberate and systematic absorption of technical progress resulting in increased international competitiveness. This refers to genuine competitiveness which helps to raise the standard

of living. Competitiveness and incorporation in the international economy, technical progress and social equity are treated as parts of the same whole.

The factor which did the most to bring about a convergence of positions concerning incorporation into the international economy was probably the severe and prolonged shortage of foreign exchange which resulted from the crisis of the 1980s. In order to close the foreign exchange gap a strategy is needed which, together with the renegotiation of the debt, will provide greater opportunities for generating or saving foreign exchange. Following several decades in which an import-substitution strategy was favoured, the countries of the region have, since the mid-1980s and using approaches which vary among them, been moving in the direction of more liberal economies. However, in view of the marked anti-export bias of the policies formerly followed, it is reasonable to think that it should now be relatively easier to generate an additional foreign exchange unit by making a greater export effort than to save a unit by means of an additional substitution effort.

Thus, the present debate no longer turns on whether or not the region should become part of the international economy but rather on other issues including, in the first place, those relating to the best manner of incorporation and the policy options best suited to bringing it about and, secondly, those concerning the impact which policies aimed at achieving a more vital

role in the international economy might have on the structure of distribution.

In this sense, the recovery of growth and the return to former levels of employment in the region bear closely on open-door strategies as part of a broader process of changing in production patterns. The impact of such strategies on employment and on the growth rate of the economy, depends on the composition of the production they foster and on the degree of intensity with which the various production factors are used. If, as may be expected, the production of new exports is more labour intensive than additional import substitution would be, then the effect on employment of an outward-looking policy based on technical progress would tend to be positive in the medium term. This tendency can undoubtedly be strengthened through the application of specific tax, credit, technological, training and marketing support measures.

There are, however, those who fear that such growth will have a concentrating effect since only a fraction of the labour force will be absorbed into export-related activities. The position held in this study is, however, the opposite: the benefits of such growth will tend to spread to broad segments of the population since incorporation in the international economy will mean that import substitutes as well as exports will have to meet standards of international competitiveness. In addition, links in the chain of production among activities ensure that the greater efficiency and the competitive requirements of sectors relating to tradeables will be passed on to their domestic suppliers with the result that many activities relating to non-tradeables will become exporters in an indirect sense. Finally, as long as a serious shortage of foreign exchange persists, the expansion of productive employment in activities related to non-tradeables is entirely subject to the closure of the external gap which depends solely on the expansion of activities related to tradeables.

As for worries that the liberalization of trade might have contractive effects on employment in the short term, it is pointed out in the document entitled *Changing Production Patterns with Social Equity* that this would depend on the rapidity with which the import-substitute sectors were reduced by comparison with the rate at which the export sectors expanded. The net result depends largely on whether liberalization takes place gradually or rapidly (as measured by the degree of inflexibility of the factor markets), whether or not it is accompanied by specific measures to promote exports and, most importantly, whether it is carried out in the presence of a high (neutral or even pro-export) exchange rate or a low (pro-import) exchange rate.

The second group of questions under discussion relate to the best way of bringing about the necessary incorporation into the international market. As is maintained in the study mentioned above, it would be a mistake to equate incorporation in the external market with a mere reduction of tariff and non-tariff barriers. International competitiveness cannot be achieved without changing production patterns on the basis of an ever-increasing spread of technical progress and its absorption by the production process. Technical progress is the factor which makes growth with social equity possible and brings competitiveness into conjunction with environmental sustainability.

Technical progress cannot be absorbed by the production process without improving the technological infrastructure, the entrepreneurial base and the quality of the human resources employed; policies which promote technological training and the establishment of production and recognize the systemic nature of competitiveness are also needed. This chapter summarizes some of the advances made in this connection since the document mentioned above was published.

2. Technical progress and international competitiveness

a) *The pattern of technical progress*

Technical progress is either made gradually through successive improvements in processes and products, or it consists in radical change brought about through the introduction of a new process or product. Some radical innovations are capable of transforming an entire production apparatus, and these are therefore known as "*technological revolutions*". They change the mode of production and of living and the whole geography of the international economy.

Thus, whereas in the paradigm which prevailed in the past, growth was propelled by the automotive, petroleum and chemicals sectors and the centralized systems of management and specialized institutional structures associated with those sectors, the paradigm now emerging constitutes a real revolution.¹ This paradigm combines the microelectronic revolution which started in the United States with the flexible model of organization and management developed most fully in Japan. Radical innovations in microelectronics and the computer sciences have had a powerful horizontal effect on all durable and non-durable consumer goods, impacting on the automotive sector; sectors producing widely-used intermediate goods, such as steel and petrochemicals; sectors manufacturing a broad range of capital goods and fast-growing sectors as banking, insurance, commerce and telecommunications. They also promote greater efficiency in the use of natural resources, fostering energy savings, in particular.

By the same token, the dissemination of the information technologies in the areas of design, production, distribution and marketing makes it possible to shorten the period between design and production and to respond much more rapidly to new demands, whether real or induced. While this is occurring, markets are being integrated in an attempt to reduce

communications and transport costs; to absorb new competitors, such as those from South-east Asia and to promote the increasingly rapid dissemination of technological knowledge at international level. All this has given rise to a rapid formation of alliances among enterprises from different countries and sectors in order to stimulate technological synergism and increase the capacity for fast response in the various markets.

The growing importance attached to design in combination with the automatization of production, distribution and marketing could rapidly erode the comparative advantages which are based exclusively on unprocessed natural resources and cheap labour, especially if such static advantages give rise to feelings of complacency with regard to the application of advanced technologies. Moreover, the impressive energy-saving effort embarked on by the industrialized countries when they entered an "expensive energy" phase in 1973, which has affected product design, manufacturing processes, transport systems and household energy use represents perhaps the most notable achievement in a broader process aimed at saving on the use of natural resources. This process has been encouraged and promoted by the intensification of competition, the ever-closer integration of design and production, the development of synthetics, the introduction of new materials and the growing use of automatization in monitoring the progress made, which have increased efficiency leading to greater efficiency in the use of raw materials. The growing concern for environmental sustainability has worked in the same direction.

New technological trends also provide many opportunities for investment in which the radical innovations effected in products and processes can be applied to new and established industries. Most of the scientific and technical principles required in the early stages of such operations are available at universities and research centres to serve the public. As the innovative process advances, however, enterprises already established and the conglomerates they form build up knowledge

they do not share, thereby erecting barriers to the entry of new competitors.

This early phase in the innovative process is probably the best time for the countries of Latin America and the Caribbean to invest in the process and to play a productive role in it, especially in view of the possibility of applying new technologies to established industries or to other production sectors. This calls for the "creation" of production factors, particularly human resources, and for their effective coordination with other sources of competitiveness, such as support services and local markets which creates demand. There is also a need for new decentralized organizational and management systems which are flexible and based on continual innovation and improvement, thereby promoting the existence and use of the synergism which arise out of the close contact established between users and suppliers within fixed geographical boundaries.

The application of new technologies is especially important to natural resources since in many countries the primary sector still makes a decisive contribution to production, employment and the balance of trade. Moreover, no fewer than 100 million peasants live off the land in conditions of poverty and environmental deterioration. Thus, the impact had by the absorption of technology should be viewed in conjunction with the various forms of landownership and the links between different kinds of production in order to prevent the processes of labour expulsion and rural impoverishment.

No consensus exists as to the future scenario for the transfer of technology to developing countries; however, indicators point in the direction of growing "technological protectionism". This is especially true in the case of advanced technologies which the more highly developing countries need in order to stay on course. The problems such countries encounter in creating and financing new technologies may increase in the face of a relatively limited dissemination of important technologies. Export markets won over as the

result of incipient systemic competitiveness may be threatened.

Within a context of increased technological protectionism, Latin America and the Caribbean must take advantage of the alliances formed between national and international enterprises as an increasingly important channel for the transfer of important technology and must regard the strengthening of the technological base as an essential aspect of those alliances and of the new approaches to regional integration and cooperation.

b) *Incorporation in the international economy and competitiveness: competitive position and efficiency*

Competitiveness is influenced by a number of factors through relations which can not easily be quantified or even identified. For example, a high degree of openness, as reflected in a high export coefficient based on goods with a low technological content and low technological dynamism does not necessarily make a greater contribution to competitiveness than a low export coefficient based on items with high technological dynamism and content; good educational coverage and heavy spending on research and development have a positive effect on the absorption of technical progress and on competitiveness, but a factor which is just as important, if not more so, is the type of linkages which they have with production activity, the agents participating in it and the quality of the effort expended. By the same token, the size of the State is less important than the quality of the relationship between the government and production activity, as is clearly illustrated by the contrast between the United States and Japan, whose public sectors are of similar relative weight but which are radically different in the nature of the links between the government and production activity.

In order to explore factors which affect competitiveness and the relationship between them, an exercise was conducted the results of which are presented below. In this exercise, the

focus of attention was on countries in competition for the import market of the Organization for Economic Cooperation and Development (OECD) during the period 1978/1989.² The growth of the competitiveness of countries was measured by the change in their presence in the OECD market between the beginning and end of the 1980s.

For the purposes of this study, it is necessary to introduce the concepts of *competitive position* and *efficiency*. "Competitive position", in this context, means the relative dynamism of a given line of production in OECD imports, being considered "favourable" when the share of those imports increases and "unfavourable" when it decreases. "Efficiency" means the relative share of a country in sales of a given product line, this efficiency being considered "high" when the share in OECD imports increases and "low" when it decreases. In other words, a country is poorly placed when it exports goods of low relative dynamism, and it is inefficient when, regardless of the types of goods concerned, its share in the market goes down compared with that of other countries which export the same items of production to the OECD countries.³

We can therefore distinguish between four strategically different situations (figure V-1): i) favourable competitive position and high efficiency (optimum situation); ii) favourable competitive position and low efficiency (situation of missed opportunities); iii) unfavourable competitive position and high efficiency (situation of vulnerability); and iv) unfavourable competitive position and low efficiency (situation of retreat).

The absorption of technical progress influences competitiveness both through the *competitive position* —inasmuch as dynamism is associated with the technological content of the products as reflected in their design and manufacture— and through the *efficiency* of production, that is to say, in the systemic and organizational capacity to produce goods of levels in keeping with the demands of the international market.

i) "Rising" and "falling" competitiveness in countries

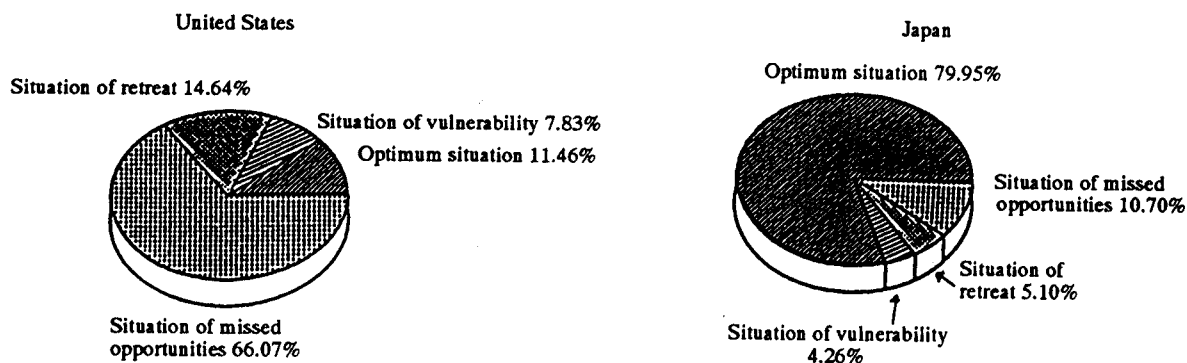
The first important distinction is between the countries which maintained or increased their share in OECD imports in the 1980s and those which lost ground in this respect. Of the 51 countries considered, 26 were in the first group, which increased its relative share of OECD imports from 44% to 56%. The second group contains 25 countries, whose share went down from 29% to 23%. Countries characterized by "rising" competitiveness increased their share of the market by 27%, while those with "falling" competitiveness saw their share do down by 9% (see table V-1).

The countries whose competitiveness is rising combined goods competitive position with high efficiency, whereas those whose competitiveness is falling display the opposite situation: poor competitive position and low efficiency. Both groups of countries register comparable proportions of dynamic products where there is a loss of relative position and non-dynamic products where there is an improvement in relative position, with various situations coexisting in terms of competitive position and efficiency. This suggests that approaches that draw a clear line between countries which are more "successful" and those which are less so should be rejected out of hand.

In the structure of exports of countries characterized by "rising" competitiveness, there is a predominance of non-natural-resource-based manufactures (58%) which are over two and a half times their exports of natural resources, including petroleum (21%). In countries characterized by "falling" competitiveness in contrast, the most important exports are those of natural resources including petroleum (50%), while exports of non-natural-resource-based manufactures amount to 30%. The relative weight of natural-resource-based manufactures is similar in both groups of countries (see table V-1).

Figure V-1

UNITED STATES AND JAPAN: GLOBAL BREAKDOWN OF COMPETITIVENESS

Situation in 1989, by main product groups^a

	Japan	United States
Global share 1987-1989	8.15%	10.07%
Variation compared with 1978-1980	+76.09%	-1.54%
Optimum situation	Motor vehicles (781) Telecommunications equipment (764) Computers (752)	Non-electrical machinery (714) Wood pulp (251) Fresh fish (034)
Situation of vulnerability	Cameras (881) Machinery (723) Textile fibres and articles (653)	Fresh fruit (057) Other wood (247) Fresh meat (011)
Situation of missed opportunities	Gramophones (763) Radio receivers (762) Television receivers (761)	Computers (752) Automobile parts (784) Aircraft (792) Motor vehicles (781)
Situation of retreat	Motorcycles (785) Universal milling machines (674) Watches (885)	Oilseeds (222) Rubber (322) Animal feedstuffs (248)

Source: Fernando Fajnzylber, "International insertion and institutional innovations",
CEPAL Review, No. 44 (LC/G.1667-P), Santiago, Chile, ECLAC, August 1991, Figure 3.

^a The three digits in parentheses indicate the corresponding group in the Standard International Trade Classification (SITC), Rev.2.

Table V-1
COMPETITIVENESS IN THE OECD MARKET

	Share in OECD imports		(% variation)	Structure of exports (%)			
	1979	1988		Natural resources	Energy	Manufactures MR-based	Non-MR-based
Countries with rising competitiveness							
Group 1	10.6	18.3	72.6	11	1	16	67
Group 2	2.9	3.3	13.8	34	8	24	32
Group 3	30.5	34.2	12.5	8	3	20	68
Total	44.0	55.9	27.0	16	5	19	58
Countries with falling competitiveness							
Group 1	22.0	21.5	-2.3	14	11	21	54
Group 2	2.6	2.0	-23.1	51	24	16	8
Group 3	4.3	2.8	-34.9	45	18	19	15
Total	28.9	26.3	-9.0	34	16	19	30

Source: Prepared by the Joint ECLAC/UNIDO Industry and Technology Division, on the basis of COMTRADE. More statistical data in this respect may be found in the article by F. Fajnzylber, "International Insertion and Institutional Innovations" CEPAL Review, No. 44 (LC/G.1677-P), Santiago, Chile, August 1991.

In both groups of countries there are varied situations with regard to level of development structure of production, and institutional makeup. Extreme cases illustrating the above statement are the United States and Japan. The first of these countries, with a share of 10% in OECD imports, saw that share dwindle by 1.5% during the 1980s, while the latter country, with a share of 8% in OECD imports, increased its share by 76% during the decade (see figure V-1). Important lines of goods, such as automobiles and computers, where Japan is in an optimum situation, have their technological and industrial origin in the United States and therefore now represent "lost opportunities" for that country: that is to say, dynamic lines of products in which it is losing its share, partly because of the process of internationalization of its own enterprises. The lines in which the United States is increasing its share are predominantly natural resources, with different degrees of processing, but two thirds of its total exports are dynamic lines of goods in which it is losing its share. In marked contrast, 80% of Japan's exports consists of dynamic lines in which that country is increasing its relative share.

ii) *Countries characterized by "rising" competitiveness*

Differences in competitive position and relative efficiency make it possible to distinguish between three groups of countries. The first group is made up of 12 countries in whose exports products combining market standing and high efficiency account for a larger share than for countries characterized by "rising" competitiveness as a whole (45%).⁴

The two Latin American countries forming part of this group (the Dominican Republic and Mexico) participate in the international market with non-natural-resource-based manufactures, thanks largely to the process of globalization of international trade whereby the leading companies in the developed countries are moving towards the use of suppliers with low

labour cost and various forms of coproduction, including assembly activities.⁵

The same two countries are the only ones in this group which registered increases in competitiveness accompanied by a drop in per capita income in the 1980s. The latter is true of nearly all the countries of Latin America and is due to the fact that progress in penetrating the international economy has been accompanied by heavy external debt service burdens and by drastic stabilization measures and processes relating to the restructuring of production.

A second group of countries where competitiveness is rising is made up of countries whose exports are efficient in terms of their production although their competitive position is not favourable (predominance of non-dynamic lines of goods).⁶ Products which are in a situation of vulnerability, together with natural resources, predominate, along with a high proportion of natural-resource-based manufactures. Only one of the seven countries making up this group (Norway) has a high per capita income, and four of them are in Latin America (Brazil, Chile, Costa Rica and Uruguay). The greater share in international trade attained by these countries in the 1980s is basically due to their having improved their efficiency in the production of mainly non-dynamic lines of goods. With the exception of Brazil, they are small countries in the process of liberalization and with high educational coverage, where the demands of systemic competitiveness can be met to a relatively high degree. Their small size allows them to improve their relative position in the export of non-dynamic products and to gain a global share in their market. Their situation is vulnerable, however, because of the low dynamism of the products they export and the price fluctuations affecting a number of them.

It is interesting to compare the situations of Brazil and the Republic of Korea, which, in spite of obvious differences with regard to natural resource endowment, international trade incorporation strategy and the presence of foreign firms (which is notably greater in

Brazil), have in common a diversified production and export base. It may be seen from figure V-2 that both countries share a similar structure of manufactured exports, including lines that make intensive use of labour and footwear), partly processed natural resources (wood and iron ore) and capital intensive goods (motor vehicles, iron and steel products). If we look at the total range of products in which these two countries have increased their relative share (products in an optimum situation plus those in a situation of vulnerability), we see that in Brazil the proportion of these products comes to 87% and in the Republic of Korea, to 93%, although it should be noted that 83% of the latter country's exports is made up of products which, as well as increasing their relative share, display greater dynamism than the international market as a whole (this proportion is even slightly higher than that for Japan).

The third group of countries characterized by "rising" competitiveness is made up of nations whose exports are predominantly of dynamic lines of goods (47%) although their relative position in those exports is declining (situation of missed opportunities).⁷ Their products are of high technological content, but their efficiency in production and marketing seems to be lagging behind compared with their competitors.

In short, those countries which are characterized by "rising" competitiveness include many of the countries of Western Europe and East Asia and mediterranean and Latin American developing countries which are tending to penetrate the market partly through the process of globalization of the enterprises of the developed countries. In recent decades, in spite of many differences in their characteristics, the countries leading the "rising-competitiveness" group—Japan and the Western European nations—have a shared form of economic and social functioning which has tended to favour agreements and negotiation.

iii) *Countries characterized by "falling" competitiveness*

Depending on the relative importance of a poor competitive position or of lower efficiency, here too it is possible to distinguish three groups. The first group is made up of countries whose products have a good competitive position but which are losing market shares.⁸ The market share of this first group of "falling-competitiveness" countries fell from 22% to 21.5% in the 1980s.

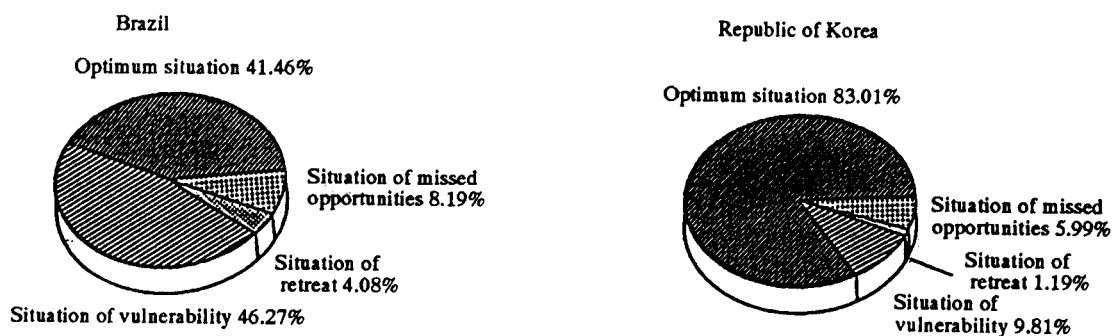
The second group of "falling-competitiveness" countries includes countries whose weakness lies in the poor competitive position of many of their products, which is not offset by the relatively high efficiency of the countries concerned.⁹ Their predominant feature is a situation of vulnerability (56%) and reliance on exports of natural resources, including petroleum (75%).

The third group, containing countries in which there is both a poor competitive position of their products and low efficiency of production, displaces a predominant situation of withdrawal (46%).¹⁰ The Latin American countries in this group share the feature of having a low proportion of non-natural-resource-based manufactures (less than 20% of total exports) and relatively independent levels of income and development since the group contains countries at both ends of the regional scale of incomes.

To sum up, the countries characterized by "falling" competitiveness include nations which have successively been leaders of the world economy (the Netherlands, the United Kingdom and the United States); the centrally planned economies; most of the economies of Latin America; some Asian countries with a strong natural resource endowment (Indonesia, which is rapidly expanding its exports of manufactures, the Philippines and Malaysia) and, finally, two developed countries (Australia and New Zealand) whose market share is based predominantly on natural resources and which have failed to follow international market trends sufficiently.

Figure V-2

BRAZIL AND THE REPUBLIC OF KOREA: GLOBAL BREAKDOWN OF COMPETITIVENESS

Situations and main products in 1989^a

	Brazil	Republic of Korea
Global share 1987-1989	1.18%	2.10%
Increase over 1978-1980	20.14%	127.79%
Optimum situation	Canned fruit (058) Footwear (851) Aluminium (684)	Footwear (851) Motor vehicles (781) Clothing (848)
Situation of vulnerability	Coffee (071) Iron ore (281) Animal feedstuffs (081)	Universal milling machines (674) Textiles of artificial fibres (653) Iron pipes (678)
Situation of missed opportunities	Internal combustion engines (713) Textile yarns and fibres (651) Fresh shellfish (036)	Fresh fish (034) Underwear (844) Textiles yarns and fibres (651)
Situation of retreat	Cocoa (072) Worked wood (248) Sugar (061)	Fabrics of textile fibres (654) Raw tobacco (121) Worked wood (248)

Source: Fernando Fajnzylber, "International insertion and institutional innovations", *CEPAL Review*, No. 44 (LC/G.1667-P), Santiago, Chile, ECLAC, August 1991, Figure 6.

^a The three digits in parentheses indicate the corresponding group in the Standard International Trade Classification (SITC), Rev.2.

iv) *Competitiveness, natural resources and sustainable development*

The fundamental difference between Latin America and a number of OECD countries with a generous natural resource endowment resides in the fact that in the latter industrialization was heavily based on the processing of those resources. At the same time, they developed technologies favouring the integral use of natural resources, which allowed them to successfully combined technical progress, competitiveness, natural resources and environment.

Policies relating to the processing of basic commodities can, for example, actually increase systemic competitiveness by bringing about improvements in transport, marketing and financial systems. Two essential links between natural resource sectors and industrial activity and services are the capital goods industry, and the specialized machinery and equipment branches, in particular, on the one hand, and the engineering services, on the other, both of which play a decisive role in promoting productivity and the spread of technology.

Thus, although generally speaking natural resources are characterized by lower dynamism in international markets, they offer considerable potential, in addition to their importance as foreign-exchange generators, for the learning of improved business practices, the spread of technology and the promotion of manufacturing and related services. That potential can be developed by abandoning an excessively sectoralist approach and tackling the problem of the lower dynamism displayed by natural-resource-based product lines by establishing policies promoting the absorption and spread of technology, the creation of links to secondary and tertiary activities and the achievement of progress in commodity processing and marketing. All these areas are also important in the establishment of regional cooperation which promotes competitiveness.¹¹

A structure of exports which relies heavily on natural resources is also exposed to pressure from international markets regarding environmental standards —an issue

which makes it all the more important that technology be absorbed in such a way as to reconcile competitiveness and environmental sustainability.

v) *The implications of strategy lines*

In spite of its many limitations —the most important undoubtedly being the impossibility of projecting past trends into the future, especially in a period of transition between two different technological models—, the previous exercise illustrated the diversity of options for incorporation into the international economy.¹² Thus, a number of preliminary conclusions may be reached concerning countries' competitive position and efficiency of production.

With regard to the competitive position or different lines of goods:

a. *Non-natural-resource-based manufactures*, which of course include the equipment and inputs used to process natural resources, form a major and growing part of international trade.

b. *Withdrawal from declining markets* is not always the best policy. In the first place, greater efficiency of production may raise a country's share in the market of a line of goods enough to make up for that market's lack of dynamism, as illustrated in the case of the "income" associated with the production of some of the region's natural resources. Furthermore, advantage can be taken of this increased efficiency by incorporating it into the chain of production, using any forward and backward production linkages to increase the value added and to diversify production by moving into more dynamic lines, which here again might involve the industrialization of natural resources. Nevertheless, declining markets constitute a warning signal suggesting the need to take advantage of that source of income —while it lasts— to look for opportunities for greater diversification or conversion. The smaller the share of the country in the market for the line of goods concerned and the greater that country's relative efficiency, the longer the time which may be spent on this quest.

With regard to efficiency an absorption of technical progress:

a. The absorption of technical progress is important with regard both to the characteristics of the various lines of goods produced and the organizational efficiency with which they are produced and marketed. Just as important as the acknowledged link between markets standing and technical progress is the combination of technical progress and organizational efficiency required for international competitiveness.

b. Items which combined rapid growth with high efficiency (optimum situations) form a potential source of power for spreading technological progress to the rest of the productive sector. The challenge with regard to institutional renewal is that of designing mechanisms and incentives to promote this dissemination process.

c. In cases of fast-growing product lines where a country is losing its share of the market (situation of missed opportunities), consideration should be given to the possibility of implementing sectoral restructuring programmes to gain and improve on the positions previously reached.

To state the case more generally, it may be concluded that systemic support of the absorption and spread of technical progress and the use of selectivity in promotion efforts seem to accompany successful experiences. In actual fact, it may be observed that among those countries which are characterized by "rising" competitiveness, Western European and Asian countries predominate and that, in spite of the differences between them, they share two main characteristics, the first of which is close cooperation between government and the entrepreneurial sectors reflected in a broad range of incentives and institutional mechanisms in support of international competitiveness. The second characteristic they share is emplacement based on fast-growing items. These two characteristics seem to be mutually supportive, facilitating decisions concerning a country's competitive position and thereby providing a valuable opportunity for debate concerning the kind of intervention most apt to result in

incorporation in the international market on the basis of genuine competitiveness.

Where the countries of Latin America are concerned, the trends towards falling remunerations and the plundering of natural resources recorded in the 1980s can hardly be expected to continue into the future. For that reason, countries which have increased their share in the market and those which have lost ground will need to make a deliberate effort in the 1990s to improve their competitive position and to base their efficiency on increased productivity. This means designing policies and institutions capable of bringing about a change in production patterns compatible with the requirements of the international market for dynamism and dissemination of technical progress. This subject is discussed below.

3. Policies for changing the structure of production

The ECLAC proposal as to how to enhance the region's role in the international economy attaches primary importance to technical progress. Actually, the pressing need to make competitiveness and social equity compatible within a framework of environmental sustainability explains why special attention is given to factors which play a role in the absorption and spread of technical progress. These factors include, in particular, the entrepreneurial base, human resources and the technological and communications infrastructure. If these factors have been weakened, it is very likely that even if the liberalization of trade may have a positive effect on the allocation of resources in the short term (static efficiency), it will be of no help in setting off a process of absorption and dissemination of technical progress leading to genuine competitiveness and ultimately to incorporation into international trade.¹³

Another salient feature of this proposal is the importance it attaches to emplacement and the policy implications this has. The fact that incorporation depends on the specific product

lines in which it has been possible to instill technical progress and to acquire competitiveness opens up the possibility of applying two kinds of selective policies in the realms of incorporation and technological absorption: First, an attempt may be made to select items apt to constitute support, in which there is *prima facie* evidence that the country concerned has the potential to acquire a dynamic comparative advantage; secondly, a pro-export bias may be introduced for a time in order to take advantage of the industrial platform built up during the substitution phase, just as a bias in favour of import substitution and unfavourable to exports was introduced in the past.

a) *Sectoral policies*

Although impressive theoretical arguments can be adduced for supporting particular lines of products, it remains to be seen how effective such policies actually are in practice. Support by the public sector of changing production patterns and incorporation in the international economy is characteristic of the development experience of South-east Asia and Japan and, to a lesser extent, of other developed countries as well.¹⁴

Although sectoral policies in the United States and Europe have been severely criticized, those applied in Japan in support of certain new manufacturing activities are usually considered to be very successful.¹⁵ Some of the sectors which Japan called new and promising, had to be treated as sectors in decline in Europe and the United States.¹⁶

The case of the Republic of Korea has even greater relevance for Latin America since this is a country where industrialization came very late. After an initial period when protection was provided for strategic sectors, such as heavy industry and chemicals, rapid progress was made (in the 1960s) towards an export-promotion strategy. New strategic sectors were identified and increased support was provided for the penetration of foreign markets through the creation of trading companies. As the result of an adjustment at the

beginning of the 1980s, a large amount of direct State control was eliminated. Even so, the State has actively promoted industrial restructuring and continued to intervene in favour of small and medium-sized business, increased productivity and research and development¹⁷ (see box V-1).

In short, experience with regard to the usefulness of sectoral policies is varied (see boxes V-2 and V-3). The fact that misguided intervention can prove just as serious as market errors is an indication of the importance of competition, social legitimacy and the operational capacity of institutions responsible for policy design and execution. In view of the deterioration of government institutions in many countries of the region in the past decade, these institutions would first have to be restructured before going on to formulate such policies.

b) *An export bias*

On the other hand the greatest achievements seem to owe much to a style of intervention in keeping with the functioning of the market and market trends which keeps large relative-price distortions from occurring. In more concrete terms, success is often achieved through external sales incentives (although limits are placed on their duration and they are made conditional on the attainment of specific export goals). Actually, although sectoral policies in much of Asia are similar to industrialization policies in Latin America, they differ from them in that their bias is exactly the opposite in that they favour exports rather than substitution, provide for the constant monitoring of the activities supported and the application of sanctions when relevant¹⁸ and advocate the strengthening of the institutions responsible for providing the support.

Although it might be considered difficult to identify areas of production with the potential for absorbing technical progress more rapidly, it would not be so hard to introduce a *temporary* pro-export bias into economic policy. Depending on the situation, this bias could be applied

Box V-1

TECHNOLOGICAL SUPPORT INSTITUTIONS IN SOUTH-EAST ASIA

Because of competitive pressure on their export markets, the highly dynamic economies with great export dynamism in South-East Asia have established institutions which specialize in looking for, and assimilating and disseminating technologies. In the Republic of Korea, the Small and Medium-sized Industry Promotion Corporation (SMIPC) provides financial assistance and training and information services and technological and managerial assistance. The Korean Institute of Economy and Technology (KIET) is an independent institute for economic research and technical information established to support the competitiveness of Korean enterprises in foreign markets. With five offices outside of the country and many representatives of the private sector in its governing body, the Institute devotes much of its activity to the identification of market opportunities for Korean products and to assisting Korean enterprises wishing to take advantage of these opportunities. KIET also has an extensive on-line data bank connected to international data sources. The network is accessible from 16 major towns in Korea. The Korean Productivity Centre (KPC) promotes the adoption by local enterprises of automatized production processes based on microelectronics. A flexible automatization demonstration centre is available for showing technological advances and providing training and technical assistance in their use.

In Taiwan, the Chinese Productivity Centre (CPC) does not provide financial assistance but concentrates on training and technical assistance. In addition to offering an extensive range of courses and technical information, it sends teams of experienced engineers to visit plants throughout Taiwan to assist manufacturers in solving specific problems in the realms of technology and productivity. These teams study the problems and make recommendations for overcoming them. In two years CPC visited over 1 000 plants and made more than 4 000 recommendations. It also carried out over 500 research projects to raise efficiency in production. In the case of major technological problems, CPC arranges contacts between entrepreneurs and specialized research centres.

Source: Economic Commission for Asia and the Pacific (ESCAP), Industrial Restructuring in Asia and the Pacific (ST/ESCAP/960), Bangkok, 1991.

across the board, only in the case of "non-traditional" exports or only to "pioneer" exports (new exports or products exported in a certain minimum amount).

There are a number of reasons which justify the introduction of such a bias, apart from the relative success of pro-export policies in newly industrialized countries. In the first place, the effects of the long duration of the anti-export bias can be mended only through policies which provide clear indications that entrepreneurial resources and talents are to be redirected towards external markets. This would mean that better use could be made of the industrial platform created for import substitution, whose expansion is prevented by foreign exchange limitations and the small domestic markets in most of the countries of the region. Secondly, exporting introduces more complexities than producing for the domestic

market, in terms of quality, marketing, timeliness, flexibility and financing. Thirdly, if any "emerging industry" exists in the region today, it is associated not so much with production as with the penetration of external markets. For all these reasons, temporary incentives in favour of exports would seem to be justified.¹⁹

Export promotion is thus a specific component of changing production patterns at the economic and commercial policy level. Depending on national requirements, such a policy, which favours exports in general but remains neutral as to specific exports, may be strengthened through the selective use of the instruments of promotion, concentrating on pioneer exports, industrial exports, exports which promote the spread of technology or exports to specific markets.

Box V-2

POLICY GOVERNING THE AUTOMOTIVE INDUSTRY IN MEXICO

The Mexican automotive industry is a case where success has been achieved in adapting competition to international conditions and to new economic policy orientations. After 35 years of growth under the protection of a differentiated tariffs system, at the beginning of the 1960s, as a result of pressure on the balance of trade, the sector began to concentrate on strengthening the degree of integration into the national market through the establishment of minimum requirements for local content, stimulating the growth of the production of automobile parts and restructuring its assembly plants. In 1972, the enterprises in the sector required by decree, to use exports to cover some of the foreign exchange needed for imports. Production quotas and ceilings on the number of models to be produced were established in an effort to adapt to the size of the market and make use of economies of scale. Later on these provisions were made more flexible, and export promotion was strengthened; however, in 1981 the automotive sector accounted for 58% of the country's trade deficit. In 1983 a decree was issued for the purpose of rationalizing the automotive industry by orienting it towards the net generation of foreign exchange.

The change which had the greatest impact on the sector was external, however. As a result of the loss of competitiveness by manufactures in the United States in their own market, in 1985 the exportation of vehicles from Mexico to the United States was put on a formal basis. These exports were very profitable in terms of generating foreign exchange and the modernization of production facilities and the vehicles produced in the country. Fiscal support measures were necessary, but these were very different from sectoral import-substitution policies in respect of their specific modalities and certainly with regard to the market for which the vehicles were being produced. In connection with the establishment of the Ford plant at Hermosillo in 1985, the Federal Government, the state government and some mixed enterprises made the following contributions: extension of the pipeline from Cananea to Hermosillo; donation of land required; establishment of railway facilities and access routes for the plant and acceleration of the construction of the four-lane highway between Hermosillo and Guaymas; payment of part of the cost of the land antenna for the satellite connection; interconnection of circuits to the electricity network; construction of an aqueduct and strengthening of vocational training programmes and of the Hermosillo Technological Institute.

At the end of the 1980s, sectoral policies in Mexico were radically changed. In order to make the country's industry internationally competitive, a trade liberation and deregulation policy was in view of the importance of the automotive industry to the economy, however, some special regulations pertaining to it remained in force for some time. The change in the economic policy made it necessary to adopt new kinds of government incentives for the sector; thus, in the near future, the main concerns of the sector will relate to the trade integration agreement with the United States, the subject of motor vehicles being very prominent in the negotiations relating to this agreement. The current policy of the Mexican Government seeks to coordinate the legislation and technical standards of the two countries, which is essential if the plants established in Mexico are to compete successfully.

4. Policies relating to the absorption of technical progress

Genuine competitiveness calls not only for policies which change the structure of production but also for policies which promote more rapid absorption and dissemination of technical progress. The latter cannot be accomplished through "price adjustments" alone. In actual fact, the absorption of technical progress depends first on strengthening the entrepreneurial base, the technological infrastructure and the production linkages,

especially in key activities like information and telecommunications which increase systemic competitiveness, and second for a heavy investment in human resources. In the following section, a study is made of the progress being made in the first of these areas (the second area is dealt with in chapter VIII).

a) *Strengthening of enterprises*

The strengthening of enterprises in Latin America is essential if progress is to be made

Box V-3

THE INFORMATICS POLICY IN BRAZIL

The development of the informatics industry in Brazil over the past 15 years has been based on a market-reserve policy, under which the Government protected the whole market and placed restrictions on foreign capital. In spite of the tremendous industrial and technological growth recorded by the sector in the 1980s, some structural weaknesses persisted, and criticism spread concerning the way in which the national industry was operating, which caused the informatics policy to loose support.

The crux of the matter is that the establishment of this new industry brought users up against high relative prices and problems relating to the quality and reliability of its products. At the same time, the structural policies in support for the sector displayed weaknesses, particularly with regard to the building of a scientific and technological infrastructure, owing to the constraints placed on public spending in the crisis decade. In addition, limitations on foreign investment in the sector affected activities by operating as formidable barriers to the inflow of capital, also keeping the earnings of national enterprises down. Finally, inflation and recession put constraints on the spread of technology in the industrial sector while successive devaluations affected the financial situation of the informatics sector, which had to bear the costs of a high investment in conditions of growing indebtedness.

In 1989 the informatics policy was restated in an attempt to promote the sector's competitiveness by gradually eliminating the tariff and non-tariff barriers erected against it. The definition of "national enterprise" was recouched to permit foreign participation to the extent of up to 49% of the capital of enterprises. The idea of an integrated policy for all the electronic industries was supported, with microelectronics and programmes being identified as priority areas and as preferential credit targets of industrial policy. Tax exemptions and accelerated depreciation privileges were granted in respect of investments in industrial modernization made by informatics and industrial automatization user sectors.

towards integration in the international economy on the basis of genuine competitiveness. The diversity and structural heterogeneity which characterizes enterprises in all countries of the region make it necessary to identify some key factors on which analysis and policy should be concentrated in the medium term.

Only two such factors are examined in this study: the dynamics of expansion in the exterior of the leading industrial conglomerates and financial support to small and medium-sized business. These are dealt with differently since the studies available on them differ radically in depth and scope. In the case of the leading capital-stock enterprises in the Latin American countries, the study contained herein may be the first study ever on the international expansion of such enterprises by means of direct investment in the 1980s. The study represents an initial attempt in support of policies which strengthen the foreign investment process, taking into consideration the necessary assessments of their

impact on the competitiveness and level of activity of the countries of the region.

As for small and medium-sized businesses, recommendations are formulated concerning measures for the provision of financial support in market conditions which allow for the full development of the potential of such businesses for consolidating comparative advantages of the countries of the region. This subject is introduced in this chapter and developed in greater depth in chapter VII.

i) *Internationalization of leading Latin American enterprises*²⁰

Since the mid-1970s at the latest, the leading enterprises of the region have been engaged in an intensive process of incorporation in the international market, which resulted in a heavy private debt in the exterior in the 1970s and in a spurt in exports in the 1980s.

The internationalization of production is dependent upon simultaneous and coordinated advances not only in the realms of international commerce and of financing but also in connection with investment in the exterior and flows of technology. Actually, the conquest of dynamic external markets has been causing countries to consider the need to gain a position in the international market by investing directly in their own import markets in order to gain advantage in the purchase of services (financial, distribution and marketing services), to avoid restrictive trade practices and to be among the forerunners, in absorbing technological innovations which make it easier to respond to trends in demand. Investment in the exterior also makes it possible to reduce the uncertainty associated with exports to foreign markets by penetrating them from within.

In actual fact, a number of enterprises in the "newly industrialized countries" of eastern Asia as well as in Latin America are investing heavily in the exterior, especially in the most highly developed countries, for the very reasons given above. Investment in the exterior not only makes it possible to profit from the advantages of internal trade between industries and enterprises, using it as a way of penetrating markets, but also opens up interesting alternatives for investment and the acquisition of technologies barred from the international market.

Direct investments by Latin America in the United States, the main recipient of such investment, have grown tremendously, the net position of Latin American countries having nearly doubled between 1987 and 1990, rising from about US\$4 billion to slightly more than US\$7 billion, with sales valued at close to US\$14 billion in 1989.²¹ Although these figures are still modest by comparison with the total foreign investment in the United States, they are an indicator of steady progress and significant absolute volume from the perspective of the countries of origin of those investments.

The countries which tip the balance in this direction are Venezuela, Mexico and Brazil

(Panama being excluded by virtue of its position as a tax heaven). By looking at national case studies carried out in those three countries and in Argentina, Chile and Colombia,²² it is possible to detect the main characteristics of the direct investment effected by the largest enterprises in the countries concerned. These characteristics include:

- Brazil, Mexico and Venezuela (see boxes V-4, V-5 and V-6) began to expand internationally in response to the crisis of the 1980s, and, in the case of Brazil and Mexico, their investments are concentrated in the United States. In Argentina, Chile and Colombia, enterprises tend to direct themselves primarily towards other Latin American countries. The restructuring of Argentine industry in the 1970s and 1980s is reflected in a profile of Argentine enterprises which embarked on a course of internationalization at that time. The incipient process of foreign investment by Chilean enterprises also reflects a process of restructuring, of equal magnitude as that in Argentina. The expanding petroleum base of the Venezuelan economy plays a decisive role in the volume and structure of Venezuela's foreign investment.

- Concentration by country of destination is related to marked concentration by economic sector of destination, by considering the size of investments rather than the number of projects completed (excluding investments in the financial sector), it is possible to identify sectoral specializations—e.g., Venezuelan investments in petroleum and related industries, Mexican investments in non-metallic minerals manufactures and Brazilian investments in motor vehicle parts (see box V-4).

- The development model and policies of each country have had a decisive effect on the degree of impetus given to investments abroad.²³ In the case of Mexico, there is a close connection between its development model, which is, by comparison with that of Brazil, more open to the exterior, and the larger size of the external investment of its leading economic groups. Although the Brazilian equivalents of those groups are the same size as their Mexican

Box V-4

**EXCELLENCE IN QUALITY AND INVESTMENT IN THE EXTERIOR:
METAL LEVE, S.A.**

The Brazilian firm Metal Leve, S.A., was founded in 1950 to produce parts for automobile motors, especially pistons, its sales being directed primarily towards the domestic spare-parts market. At present, Metal Leve is the second most important enterprise in the automobile parts industry in terms of volume of sales (US\$366 million in 1989) and is considered to be the leading enterprise in the sector in terms of efficiency, innovation and quality.

The penetration of the international market by means of exports began in the 1960s. Metal Leve found a definite niche in the market for pistons for airplane engines and was certified by the Federal Aviation Agency of the United States. In the 1970s, the market in the United States was expanded to include sales to Caterpillar of diesel engine parts. In 1985, three affiliates were established in the exterior (London; Ann Arbor, Michigan; and Weinstadt, Germany) to provide technical and commercial assistance efficiently, continuously and rapidly to purchasers of its exports from Brazil. These affiliates also made it possible to keep close track of the progress made in the automotive industry in large production centres. Finally, in 1988, the firm established a plant for the production of pistons in Orangeburg, South Carolina, and a high-level technology group in Pittsfield, Michigan.

The decision to go international was taken by the directors of Metal Leve because of the technological dynamism of the pistons market, whose success depends on its participation in the international production of engines, in which new products and materials technologies are identified. The basic strategy is that the enterprise must be close to its clients when they begin to think about manufacturing a new engine. In the 1970s, the client (the terminal enterprise) would specify how a product was to be designed in every detail. Beginning in the 1980s, the terminal enterprise began to define the role of the product, while its design was left to the producers of parts and components. This was the case of the articulated piston developed by Metal Leve for Caterpillar and Volvo.

Changes in the dynamics of the industry caused Caterpillar to ask Metal Leve for prompt delivery of its pistons and to manufacture them in the United States. In order to keep its market with Caterpillar, the Brazilian firm was forced to invest the equivalent of 5% of its yearly sales to construct the plant required in the United States, whose sales amount to about US\$15 million a year.

While making that investment, Metal Leve decided to establish a motor-joint factory in Indiana as a joint investment with KS of Germany (the firm which competes with Metal Leve in the Brazilian market for motor joints). In July 1991 the technological centres associated with these two enterprises in Brazil and Germany embarked on a process of close cooperation.

The internationalization of Metal Leve appears to be following a pattern in which excellence in quality and innovation is used to win international markets. Changes in the context of changing relations between client-supplier relationship made it necessary to safeguard these achievements by establishing a strategy of direct investment in the exterior, which may in the near future lead to the establishment of a plant producing pistons in a country in the European Community.

counterparts, they are less apt to engage in external investment. Thus, for example, although the economic size of the leading television channels (TV Globo in Brazil and Televisa in Mexico) are relatively similar, the scope and time-frame of Televisa's international activities are much broader. This is a close parallel to the greater degree of internationalization of the large Mexican industrial conglomerates by comparison with

Brazilian conglomerates with an equal amount of capital.

- Investments by Argentina and other countries prior to the 1980s were a "natural" outreach of efficient import-substitution processes and enterprises. In some cases, that expansion was accompanied by the transfer of appropriate technologies developed or adapted in those same sectors or enterprises. The protection provided by the markets of host

Box V-5

LARGE FOREIGN INVESTMENTS BY MEXICAN PRODUCERS OF GLASS AND CEMENT

In 1989, after consolidating their position in the domestic market, VITRO, S.A., and Cementos Mexicanos S.A., two large private-sector conglomerates financed by Mexican capital, embark on a powerful campaign to make direct investments in the United States market.

The first successful hostile take-over of an American concern by a Mexican conglomerate was done by VITRO, a holding company which is the leading producer in Mexico of glass containers, flat glass, glass-making machines, car windows and car windshields and household appliances, and whose sales reached US\$2 850 000 000 in 1990. Around the end of 1989, VITRO acquired 95% of the Anchor Glass Container Corporation, the second largest glass container manufacturer in the United States. The cost of that acquisition is estimated at more than US\$900 million, including US\$460 million in Anchor debts and the purchase of the Latchford Glass Company for US\$48 million.

VITRO has long experience in joint operations with large companies in the United States (Ford, Ingersoll Rand, Owens-Corning Fiberglass and Whirlpool); however the strategy which led to the purchase of Anchor glass was adopted fairly recently. According to statements made from its top office, VITRO invested in the exterior because it wished to continue producing glass but its dominant position in the Mexican market along with some exports (about 25% of its sales) was no longer enough to keep it satisfied. "With a more liberal Mexican economy, our strategy had to change".

Although the strategy applied by VITRO was probably the only way the enterprise could remain a world-level producer in an industry which was being drastically overhauled, the fact that a Mexican enterprise was able to follow such a strategy is particularly noteworthy. In 1983 VITRO's external debt amounted to US\$758 million; six years later, after renegotiating with its creditor banks and taking advantage of government support to convert its debt from dollars into pesos, the enterprise owed only US\$15 million. An efficient diversification policy and the support provided by the Government in converting the debt were at the bottom of the enterprise's new strength at international level.

In the cement industry, Cementos Mexicanos S.A. (CEMEX), another Mexican private conglomerate, also decided to make direct investments in the United States after having bought out its leading competitor in the domestic market in order to keep it from being absorbed by a major world-level producer.

The CEMEX purchases were concentrated on plants producing cement and concrete owned by Blue Circle Industries. Its purchases in Mexico allowed CEMEX to increase its share in the domestic market by 20% and to protect its exports to markets in the south of the United States. The Blue Circle purchases and the acquisition of plants in the states of California, Texas and Arizona made CEMEX the fourth largest producer of cement in the world, with sales amounting to close to US\$1 350 000 000. Its international diversification strategy will, according to its directors, allow CEMEX to increase its efficiency by economizing on the operating expenses of many of its plants, to improve its distribution channels and to reduce its transport costs. Given the size of the investments made by VITRO and CEMEX in the United States, it is quite clear that those firms are following strategies under which the elements which define the structure of their industries and their competitive position are determined in an integrated Mexican-US market place. In both cases, international expansion was a natural step for private-capital conglomerates which had consolidated their positions in the domestic market and could defend those positions only by becoming world-level businesses.

Box V-6

THE INTERNATIONAL EXPANSION OF PETROLEOS
DE VENEZUELA, S.A. (PDVSA)

The international expansion of Petróleos de Venezuela, S.A. (PDVSA), the Venezuelan state enterprise, has turned it into a multinational corporation in the strictest meaning of the term. The first step in the direction of internationalization was taken in 1983 when an association was formed with the German firm Veba Oel. The company formed has refineries (300 thousand barrels a day) and petrochemical plants and is a large shareholder in enterprises operating shipping terminals, storage plants and pipeline networks. The second large transaction was the purchase of CITGO, an enterprise engaged in refining, distribution and marketing; the production, mixing and bottling of fuels and the operation of pipelines for oil and other products. In 1986 PDVSA joined with the Swedish firm Neste Oy to form the enterprise known as Nynas Petroleum, in whose ownership each of the partners holds 50% of the shares. This association gives Venezuela access to the European market for special petroleum products.

Between 1987 and 1989, PDVSA purchased the Champlin Refining Company of Corpus Christi, Texas, thereby acquiring 50 distribution terminals covering 10 states in the south and southeast of the United States, where it markets close to 120 000 barrels a day. The refinery also has the capacity to process heavy crude with a high sulphur content and is equipped to produce gasoline which meets environmental standards in the United States.

Since 1989 PDVSA has owned half of the Middle East assets of the Union Oil Company of California, including all of the assets of a refinery in Corpus Christi. In addition to the refinery, PDVSA purchased a plant for mixing and bottling lubricants, which has four terminals; 12 terminals for motor vehicle fuels; one for airplane fuel and its own network of service stations. This whole enterprise is known as the UNO-VEN Company.

In 1989, PDVSA rented a government-owned refinery on Curaçao owned for a period of five years renewable. The same year it also purchased outright the Bonaire Petroleum Corporation N.V. (BOPEC), whose assets include a 9.5-million-barrel terminal, for the purpose of consolidating deliveries of crude and petroleum products to its clients, especially in the United States. For the same reason, it purchased a petroleum terminal in Bahamas with a storage capacity of 20 000 barrels of crude and petroleum derivatives and a deep-water port.

The primary result of the strategy of purchasing abroad has been the increased integration of PDVSA. At present, it is the most solidly integrated of the 10 largest enterprises in the world in the area of petroleum, the ratio between production of liquids (2 001 000 barrels a day) and sales of products (1.8 million barrels a day) is 110%. By making direct investments in the exterior, PDVSA is able to effect considerable increases in the average price of its export package, which would otherwise be composed of relatively heavy crude with a low market price.

countries operated as an incentive for that expansion and at the same time as a mechanism for maintaining markets conquered by means of exports.

The changes effected in organizational and production methods and techniques of industries which consume goods exported from Latin America have also been used as arguments for the installation of plants in the markets where those industries are located.

There are no practical evaluations of the impact made by the investments effected by Latin American enterprises abroad. In particular, little is known concerning the repercussions of such investments on the international competitiveness of countries in which the head

offices of such enterprises are located and still less concerning their effects on the level of well-being in those countries.²⁴

The contribution made by government policies to the internationalization of the region's enterprises has still by no means been determined. However, even without exact evaluations concerning the impact of such policies, it may be affirmed that progress in negotiating agreements which prevent double taxation and eliminate unnecessary barriers to the flows of capital needed for direct investment is enough to increase competitiveness and strengthen the entrepreneurial base of Latin American countries. Much more exact information concerning the impact of existing

policies than is now available would be needed in order to endorse additional policy measures.

ii) *The role of small and medium-sized business in the process of changing production patterns with social equity*

The full incorporation of small and medium-sized business in changing production patterns is justified by reasons of employment since the sector is labour-intensive and because the rapid absorption and spread of technology call for a broad and dynamic entrepreneurial base. In actual fact, a comparative analysis of the pattern of development in different countries shows that structures of production which are well coordinated, particularly with regard to links between enterprises of different sizes, tend to favour industrial development.²⁵

Since the term "small and medium-sized business" covers a group of enterprises of a highly heterogeneous nature, it is worth describing some characteristics of the type of small-and-medium-sized-business sector which will play a particularly important role in the development process of the 1990s. What is needed is a modern sector which aims at innovation and growth, is noted for its active role in the industrial structure and regards change as the main challenge facing the modern small-scale entrepreneur. Its competitive advantages are derived from the fact that it employs increasingly highly skilled workers so that it can specialize in products and processes, such as electronic items and other intermediate goods, which are not characterized by many economies of scale.²⁶ This kind of small-and-medium-sized-business sector has the potential to make a tremendous contribution far beyond its direct contribution in terms of employment and current value added.

a. *Small and medium-sized business and international competitiveness.* In the first place, requirements in terms of price and international quality standards are passed along to small and medium-sized enterprises through links in the chain of production with the result that, as purveyors to activities producing tradeables,

such enterprises can become indirect exporters of enormous importance to the competitiveness of tradeables by raising the quality and quantity of the inputs and intermediate goods used in their production. The direct incorporation of small and medium-sized industries in the international market for specialized products is also becoming increasingly common.

b. *Small and medium-sized business and coordination.* The industrial modernization process is giving rise to new kinds of links in the chain of production as optimum scale is redefined. Thus instruments such as subcontracting, joint marketing and joint operations, which tend to break through the old barriers between oligopolistic sectors, have come into use. The small-and-medium-sized-business sector is becoming a kind of shock absorber which softens the effect of upheavals in demand and increases the flexibility with which large enterprises respond. At the same time, the flow of personnel between large and small enterprises will be increased in order to make the most of the practical training provided. This latter effect also often makes a contribution in terms of social equity since the value added in large industries can be absorbed if small suppliers raise their level of employment. Socio-economic coordination is of great importance when it comes to stabilizing young democracies, increasing political participation and promoting the deconcentration of interests and opportunities.

c. *Small and medium-sized business and innovation.* The small-and-medium-sized-business sector can adapt more rapidly than big business to changes in management and production since its internal structures are more flexible and less bureaucratic. There are also fewer barriers to their entry into the market with the result that the large majority of new businesses are small and medium-sized enterprises, with the majority of large enterprises emerging from them as they grow.

d. *Small and medium-sized business and social equity.* In addition to its contribution to the deconcentration of industrial ownership and its positive effect on employment, a modern

small-and-medium-sized-business sector, being made up of production units which are smaller and more personalized than the units in the big business sector, offers greater facilities for monitoring the productivity of each employee so that the levels of remuneration can be adjusted accordingly. This functional characteristic lessens the risk of experiencing the imbalances which occur in very large organizations where collective negotiation and informal lobbying by a small group of employees are the rule.

The second point which needs to be made in this connection, concerns the regional dimension of small and medium-sized business within countries. Since this type of business is less concentrated in the major industrial centres, regional income distribution is strengthened proportionate to the rise of small-scale enterprises.

The four points made above refer to the contribution the sector can make provided that optimal conditions prevail. Since such conditions hardly exist in present day Latin America, it seems imperative to pay attention to factors likely to increase the contribution of small and medium-sized business. In addition to macroeconomic stability and a relative price system which is not biased against employment (and, in the last analysis, against small and medium-sized business), the following three factors stand out: technical support, public infrastructure services and financial services.

Technical support policies cover a number of activities aimed at the training of human resources in such varied fields as quality standards, design, management, market science, marketing and the transfer of technology. They also provide for programmes which promote services relating to the production and dissemination of information; the incorporation of new production links, such as subcontracting; the establishment of links between universities and the production base and the organization of small and medium-sized enterprises into cooperatives.

Infrastructure services are now undergoing a process of modernization and adaptation (telecommunications, land transport facilities, customs authorities and ports, etc.). It should be noted that certain infrastructural defects which generate costs for enterprises seem to affect small-sized units more than large operations because economies of scale reduce their impact. The administrative and institutional procedures which characterize the sector also need to be revised in an effort to attack some of the barriers to its growth,²⁷ including everbureaucratic procedures (legal and tax registers, permits, etc.), problems relating to public services (e.g., irregularities in water and energy supplies) and inadequate tax incentives.

Finally, attention is called to the importance of financial services. In this connection, a clear distinction should be drawn between financial operations designed to serve the industrial sector, on the one hand, and the financial system as a macroeconomic policy variable, on the other. While the former constitute basic components of industrial policy, the latter is at the service of a country's quintessential macroeconomic monetary and financial policy objectives. However, much remains to be done in order to facilitate the access of the small-and-medium-sized-business sector to financial markets, as noted in chapter VII.

b) *Strengthening the technological infrastructure*

International experience has shown that growth and competitiveness (at country and enterprise level) are positively related to the adoption of specific policies to further access to, dissemination of and innovations in science and technology.

The following section outlines some policy lines in this area which have worked efficiently

at international level and describes some policies which might facilitate the attainment of the objectives set forth in this strategy.²⁸

i) Policy lines

a. *Society's capacity to absorb knowledge.*

Systems of education, learning and research and development and the organizations and institutions which produce them systemically determine the capacity of a country's society to absorb technology and affect the rate at and extent to which new technologies are absorbed and disseminated and a country's potential for future innovation.

A country's science and technology policy and the partner of competitive advantages of its industry must be mutually supportive. In particular, an effort should be made to ensure that the policy is consistent with the country's industrial structure, the degree to which its competition has developed and the capacity of its enterprises and research institutions.

b. *Promoting research and development (R&D) activities in enterprises.*²⁹ Mechanisms used to promote R&D activities in enterprises or entrepreneurial associations include: i) policies which ensure great rivalry among enterprises in the commercial phase, compatible with the presence of efficient approaches to cooperation in the basic technological development phase; ii) increased modernization of domestic demand as a result of the incorporation of consumer training and information processes; iii) efforts to raise the quantity and quality of information on technologies and markets available in the country concerned; iv) availability of resources for institutions engaged in specialized research relating to industrial conglomerates; v) mechanisms for granting partial subsidies under research contracts between enterprises (small enterprises, in particular) and research institutions; vi) the provision of support for basic and applied research in universities; vii) the granting of partially subsidized credits to enterprises to encourage them to increase their demand for research and to enable them to

arrange for research with universities or by establishing their own R&D units.

c. *The application of research carried out under cooperative arrangements among enterprises.* Although it may be argued that cooperation does away with duplication, makes it possible to benefit from economies of scale and internalizes externalities, special conditions must exist if cooperative arrangements are to operate successfully. First of all, cooperation is more suitable in those areas of basic research which relate to products and processes or in research carried out to overcome lags than in areas relating to comparative advantages of enterprises; secondly, cooperation should be used only in connection with a relatively small part of the total amount of research carried out by an enterprise in any given field; thirdly, cooperative research must be carried out by institutions independent of those institutions to which the majority of enterprises in a given industry have access and, finally, it must relate to areas which affect a large number of institutions and call for large investments in R&D.

d. *Strengthening the links between research institutions and industry.* In order to establish links between research institutions and industry, mechanisms of various kinds have been used, including that of having institutions engaged in specialized research concentrate their efforts on industrial-sector conglomerates or on technology which can be applied to a number of them at points where they intercept; that of arranging frequent research contracts between enterprises and government research institutions or universities, which identify goals and ways of working together to assess the progress made as a means of increasing the efficiency of the links between them and that of explicit dissemination of technology.

ii) Policies

Without dismissing the need to call attention to the measures designed to strengthen the technology market, the following paragraphs note the action taken to increase the supply of

technology and the demand for it on the part of the production system, mentioning agents which can act as a vital link between technology supply and demand.

a. *Strengthening the supply.* Some countries of the region have designed programmes to strengthen their supply of technology by making the most efficient use possible of their skilled human resources and physical infrastructure (see box V-7). These programmes usually provide for a number of measures, including, for example, measures to increase the incentives received by institutions of higher education and technological centres to raise the quantity and quality of their supply; measures to improve the management of public-sector technological centres by having entrepreneurs participate in their executive boards, identifying indicators of effective management and updating the managerial knowledge of their directors and medium-level staff; measures calling for the use of ad hoc liaison agents to promote the supply of marketable or transferable technology in national enterprises and to encourage the transfer of technology to national enterprises from abroad and measures to develop networks for supplementing a country's stock of technology through the part-time provision of support by scientists and research workers from that country who are residing in developed countries.

b. *Strengthening the demand.* Consideration should be given here to the creation of technology management centres to promote demand for technology by business organizations and enterprises and to use state demand as a means of encouraging the creation of the mechanisms needed in connection with the transfer of technology between enterprises under subcontractual arrangements. Such centres would also promote the development of educational programmes designed to sensitize the directors and middle-level staff of enterprises to the potential offered by the technology available and to motivate them to make the best possible use of their technical capacities.

c. *Liaison agents.* The vital task of coordinating technological supply and demand

can be carried out by a variety of agents, including, for example, international centres of competitiveness in the fields of international trade, technology management and problem diagnosis and solving; services providing enterprises with support in such areas as cost-analysis and quality-improvement; entrepreneurial management centres concentrating on small and medium-sized industry and open-learning centres or programmes for small-scale entrepreneurs, chambers of commerce, enterprises with subcontracting programmes and the like.

It has been possible to identify the need to have such liaison agents available to develop the capacity for technological innovation of a number of production sectors in the region (see box V-8). To promote the development of such agents, policies may be carried out providing for the public financing on a temporary basis, as a supplement to private financing, of the mobilization of regional, sectoral or mixed agents; for the dissemination of information between enterprises and research institutions concerning existing or potential agents and the functions they perform and the creation of modern technological information systems (centres, networks, etc.) to meet the needs of various branches of industry and to be financed initially for a specified period by the public sector, after which they must finance themselves.

c) *Strengthening production linkages*

Although the systemic nature of international competitiveness is hinted at when it is considered from the perspective of countries, it becomes very apparent when it is viewed from the standpoint of products. If a given country's exports are competitive in their markets of destination, the country in question is said to be competitive in those markets. A summary follows of some of the findings obtained from field research concerning factors which have a decisive effect on the competitiveness of products, including the marketing of exports, the modernization of ports and the development of

Box V-7

CONACYT (MEXICO) PROGRAMMES IN SUPPORT OF
TECHNOLOGICAL DEVELOPMENT

In May 1991, the National Council of Science and Technology of Mexico (CONACYT) announced a package of projects in support of scientific and technological development calling for expenditure of close to US\$100 million a year to be added to the approximately US\$1 billion a year which Mexico spends on science and technology (about 0.4% of GDP).

The programmes in question include:

1. A fund for repatriating Mexican research workers and keeping them in the country.
2. A fund for strengthening the science and technology infrastructure and in particular for partially financing purchase of scientific equipment and materials.
3. A fund for creating teaching posts for distinguished scholars in institutions of higher education and research centres and institutions.
4. Funds for financing research projects in the exact, natural, earth, social, human and behavioural, applied and health sciences.
5. Establishment of a register of notable postgraduate institutions in scientific disciplines. Students whose name appears on the honour role of these institutions will be awarded scholarships covering their enrolment and course fees, a monthly allocation for living expenses and medical insurance.
6. Research and development fund for technological modernization which will finance projects whose final output will be used by private enterprises.
7. Fund for strengthening strategic scientific and technological capacities which will enable the Federal Government to join enterprises in a particular branch of the economy, Chamber of Industry or sector in participating financially in the establishment of research and technological development centres.

Box V-8

PERU: COOPERATION IN BIOTECHNOLOGY AND POTATO-GROWING

Attention should be drawn to the cooperation between a leading enterprise in biotechnology, a university and an international research centre. The results of this joint effort may produce considerable benefits for a large number of small farmers. The Agricultural Genetics Company, an enterprise registered in the United Kingdom, is one of the largest organizations working in biotechnology. Working with scientists from the University of Durham, its staff managed to isolate the genetic material of a plant known as the *caupli* which has the property of seriously upsetting the digestive system of insects which attack it. This genetic material was successfully transmitted to tobacco, and at present the Agricultural Genetics Company, the University of Durham and the International Potato Center are trying to introduce it into potatoes, the basic crop of small farmers in many developing countries.

Source: Revista Foro del Desarrollo, July-August 1991.

the information and telecommunications sector. Then some policy orientations for agro-exports are outlined, with emphasis on policies which strengthen intersectoral linkages and the systemic competitiveness of the sector.

i) *Competitiveness and marketing channels*³⁰

A product's competitiveness always relates to its markets of destination and depends on its characteristics, the place where it is available for sale, the period of time in which it can be purchased by potentially interested clients and its sales price. Thus, competitiveness depends on the efficiency with which all activities which make it possible to close the spatial, temporal and cultural gap between production and consumption can be carried out and products able to satisfy the needs and desires of their purchasers can be made available to them.

A country will be able to produce competitive exports provided that its commercial and financial regulations and practices are in harmony with those existing in international markets; government export requirements allow those participating in the activities involved to respond promptly to changes in international markets; adequate infrastructure, vehicles, equipment and facilities are available to enable exports to reach to their markets of destination and recourse can be had to the support services needed to carry out an export operation.

Countries with these characteristics will be able to establish efficient marketing channels for their exports. These channels will consist in groups of elements to carry out, in an efficient and coordinated manner, all the activities needed to ensure that the products desired by purchasers reach the markets of destination. In a number of the cases studied, it was concluded that the participation of persons and enterprises (customs agents, shippers, international trade firms, dispatchers, shipping firms, quality certification agencies and other agents) which provide specialized services along marketing channels is fully justified since they help to overcome any

differences which may exist between producers or manufactures and the final consumers. These intermediaries realize the largest proportion of the final value of exports in their markets of destination. For example, in 1990 Brazilian manufacturers of fashionable women's footwear exported to the United States received about 30% of the consumer price, while retail chains and department stores in the United States received about 60%.

In the end, in order to enhance the role played by Latin American products on the international market, existing opportunities in marketing and, in particular, in physical distribution must be seized in order to improve the competitiveness of regional exports. In this connection, emphasis must be placed on the need for competition among those agents which provide the various services which allow an export operation to be carried out. The operation of State or private monopolies in any of the activities related to the marketing of exports must be avoided.

Although the problems which prevail in this area, in particular those related to the protectionist pressures associated with the buying and selling of products on the markets of destination, are well known, it is clear that ample room exists for Latin American investment abroad and for multinational regional investments in marketing chains. This may well be an apt area for accelerating Latin American investments made as part of an integration process which, being directed towards international markets, may help to strengthen regional bargaining power and to capture a larger share of the sales price in markets of destination.

ii) *Modernization of port services*³¹

The port institutions of Latin America are the result of government directives issued in this connection over the past 50 years. In many ports of the region, systems of official and non-official employment are applied, in which titled workers subcontract tasks to their colleagues who are not officially recognized. In some cases, trade

unions have the power to veto new investments and technologies, the way in which the labour force is assigned, increases in the number of shifts, etc., which limits the efficiency of the port authority. Cargo handlers work more slowly and less economically than their counterparts in competing regions. Railway lines linking production areas with ports are poorly maintained and are not competitive with road transport. This makes costs unnecessarily high for users and reduces a country's international competitiveness.³²

The gradual adoption of export-oriented policies has not kept pace with port-system reforms. Under these policies, ports are still unable to exercise control over the trade of a territory and must redefine the services they offer and the structure of their costs, taking into account the challenges confronted by the industries they serve, the ports which compete with them and the strategies followed by shippers. Expensive, inefficient ports tend to be removed from dynamic marketing chains.

In the present decade, the ports of Latin America and the Caribbean will confront the triple challenge of increasing their productivity, reducing their costs and becoming part of international distribution chains. Solutions advocated by countries in this connection include labour laws which ensure free access to port employment and make it economically feasible for port work to proceed in three shifts, 365 days a year; free entry for private stevedoring firms; the establishment of management contracts; making the government port authority a State-owned enterprise; authorizing exclusive-user maritime terminals to move third-party cargoes, and direct sale of ports. In order to create a competitive environment, governments often associate privatization with a set of regulations which liberalize and decentralize their ports and balance the relationship between the labour force and the port authority, eliminating monopolistic practices.

Since a number of different possibilities exist, the rationalization and modernization of port activity and the service and transport

networks associated with it are of key importance to systemic competitiveness.

iii) *Information and telecommunications*³³

Information technologies play a decisive role in improving a country's competitive position and raising its efficiency in the international market. At the same time, they help to facilitate the systemic linkages between competitiveness, social equity and environmental sustainability. A technological infrastructure designed to serve the needs of information and telecommunications incorporates new knowledge, strengthens processing and compilation capacity and favours the link between all the parts of the process and the way in which they interact.

Modernization and absorption of technical progress for the purpose of increasing competitiveness call for quantitative and qualitative improvement of information circuits both within the production processes and in their interplay with their spatial and economic environment. This is accomplished not only through an overall improvement of the information processing modalities but also through the absorption of new knowledge, and of strategic knowledge in particular.

Information and telecommunications have direct and indirect effects on social cohesiveness and welfare and on social equity. Their direct effects include the impact they have on interpersonal communications and on the incorporation of marginated sectors into the economy. Their indirect effects include the contribution they make to increasing the efficiency of the education and health sectors.

From the substitution of matter and energy by information in the production processes to the adoption of new industrial paradigms (e.g., "just in time", "zero reject", "fault tolerant", "small is beautiful", etc.), technological mutations of a structural nature find powerful allies in information and telecommunications which make it possible to reverse classic cause-and-effect cycles which are harmful to sustainability by reformulating the very base on which the

production processes operate and establishing new patterns of urbanization and management. These new patterns, supported by new technologies, make it easier to save materials, energy, time, space and financial resources, promoting increases in productivity and the economic viability of less contaminating production techniques and the production of goods and services which reduce environmental deterioration.

The study of regional and international experience suggests a variety of urgent tasks for the State and the economic agents involved:

a. To develop *the telecommunications infrastructure* to the lower limit compatible with changing production patterns in such a way that opportunities are deconcentrated —a task which requires yearly investments of about 1.4% of the regional GDP or 7% of gross fixed capital formation. These investments should be so concentrated as to effect a significant increase in the density of principal telephone lines, from its present level of five lines for every 100 inhabitants to 20 lines for every 100 inhabitants, during the present decade.

b. *General overhauling of data processing operations*, concentrating on industrial automatization and on improved management of interaction, both within the production processes and in their relationship with their environment, ensuring that this is accompanied by a significant increase in connections. This investment in data processing will call for an effort similar to that made in the field of telecommunications.

c. Promoting the *dissemination of information technologies*, in particular by making up-to-date, evaluated information available as regards supply or, at least, in respect of sources of relevant data.

d. Facilitating the *circulation of information* at both national and international level, which will require studying laws relating to protection of privacy and to ownership. (If this is not done, confidentiality and opacity will prevail.)

e. *Drawing up a framework of telecommunications regulations* which makes a

clear distinction between services and physical means and provides for a normative authority with clearly defined tasks, such as that of establishing tariff-setting mechanisms operating on the basis of standards which include long-term marginal costs associated with real innovations, increased productivity and profitability, etc. This is particularly important with regard to privatization, if the option of privatization is adopted.

For the telecommunications sector, a set of regulations *structured on the basis of the following four objectives* is suggested:

a. *Universality of service*. For the purpose of giving every inhabitant of the region access to a telephone, a rate of density of 20 or more principal lines for every 100 inhabitants, with minimum waits, is suggested, as is the satisfaction of social imperatives where rural telephones and public call-boxes are concerned.

b. *An integrated telecommunications network*. The public should be guaranteed services which are fully interconnected with national and international lines, together with high standards of security.

c. *User protection*. The existence of monopolies and dominant positions makes it essential for consumers to be assured of protection and access to adequate information.

d. *Self-financing*. It is recommended that the sector should finance itself without having recourse to subsidies to finance the enormous social investment required.

iv) *Agriculture and incorporation strategies*

At present, international farm commodity markets are in a complex situation dominated by increasing competition among exporting countries and decreasing prices for important commodities. In spite of the negotiations held in connection with the Uruguay Round, the situation is not expected to change radically in the medium term. Thus, competition in respect of farm exports will continue to be very intense in the 1990s. This provides a starting point on

the basis of which strategies of incorporation into the international market can be drawn up.

Diversification, flexibility and competitiveness are the basic requirements for effective incorporation into the market for agro-exports since they promote good market standing and high efficiency in international trade. Success in the agro-export market on the basis of different degrees of dynamism displayed by commodities in international markets should be regarded as one step in a more general process of rising competitiveness leading up to the moment when access to agro-industrial development becomes a possibility. In addition to facilitating access to industrial development and the absorption of technical progress by farm activities, the development of agro-exports promotes changes in agricultural production compatible with less concentrated agrarian structures offering higher productivity and functional links between agriculture and industry—a weak spot in the Latin American industrialization process. This pattern of development is, moreover, confirmed by the recent experience of a number of developing countries, including Brazil, Chile, Malaysia and Thailand.

Productivity and competitiveness of agro-exports are also essential for successful incorporation into the international market. The steady absorption of new technologies, including biotechnology and genetic engineering,³⁴ plays an important role in this connection.

The advances made in the field of biotechnology make it feasible to predict some loss of dynamism in traditional food products since the leading research work has been directed towards new species and high-productivity hybrids which will gradually be entering the markets of industrialized countries. As technological research progresses in the region, however, it may be possible to expand the production of non-traditional products, especially tropical commodities, and to conquer new markets.

Increased productivity makes it possible to reduce costs, to introduce price flexibility and to raise wages. However, it also has a large impact

on factors more closely related to the productivity of the sector, such as good distribution of the proper techniques for harvesting, managing, packaging and transporting exports; strict observance of the plant-health norms of importing countries; the maintenance of links to efficient trade circuits, either within the exporting country or within the importing countries, as well as links to related port services; the availability of up-to-date information concerning consumer preferences in importing countries with respect to variety, size, design, environmental norms, etc., and, finally, the practice of a systemic approach to competitiveness, leaving none of the aforementioned factors out of consideration.

In view of the systemic nature of the agro-export process, the degree of competitiveness of the commodities involved also depends on the laws and domestic regulations in force. From this perspective, any measure which simplifies export procedures and procedures relating to the importation of inputs and equipment and makes them more flexible raises a country's commercial competitiveness. In countries as well endowed with agricultural resources as the Latin American countries, overall progress in connection with competitiveness will have a disproportionate and beneficial effect on the agricultural sector since it will rapidly promote the sector's latent comparative advantages.

A country's agricultural production and marketing support infrastructure is also important. Communications, highways and post-harvesting and plant-health control treatment facilities all play a role in the systemic competitiveness of farm commodity exports. Examples of this are found in the dynamic development of non-traditional agricultural exports in the region. In Brazil, for example, increases in the value of farm commodity exports (soybeans and orange juice) in the period between 1986 and 1989 exceeded the losses associated with coffee and sugar. Significant progress has also been noted in Paraguay, particularly where cotton fibre and soybeans are concerned. In Chile, fruit producers and

exporters are not only increasing and diversifying their exportable production but are also demonstrating growing flexibility in the composition of their exports, including those produced for world markets in frozen foods.³⁵

Notes

¹ Innovations which are technically and economically related make up technological systems which can affect various branches of the production apparatus. In a technological system, innovations in inputs, products and processes are combined with innovations in organization and management. "Technological revolutions" are produced by clusters of technological systems with a common dynamic.

² The level of aggregation of the analysis is the three digit level of the Standard International Trade Classification (SITC), Rev.2. The methods used may be applied to other markets at other levels of aggregation. With the right information, it may even be applied to enterprises rather than to countries.

³ The variation in the imports of a given item (i) originating in a given country (j) with respect to the variation in total imports is broken down into two components, as follows: the variation of total imports from any place of origin (which defines the competitive position of the item in question) and that of imports from the country of origin under consideration (which defines that country's efficiency). Thus, the variation in M_{ij} /the variation in M is equal to (the variation in M_i /the variation in M)* (the variation in M_{ij} /the variation in M_i). Thus, when the variation in M_i is greater than the variation in M , the competitive position of the country in question is good since the item under consideration is dynamic; and when the variation in M_{ij} is greater than the variation in M_i , the country is in a position of relative efficiency with respect to exports of the item. The variation in a country's total share in the market of destination is calculated by taking into account both the competitive position of the various items that country exports and its efficiency in each of those items.

$$(M \cdot j = \sum_{i=1}^M \frac{M_i}{M} \cdot M_{ij})$$

⁴ This group is made up of the following countries: China, the Dominican Republic, Finland, Japan, Mexico, Portugal, the Republic of Korea,

Singapore, Spain, Thailand, Turkey and Yugoslavia. In the case of China, it is interesting to note that its export coefficient went up from 4% in 1978 to 19% in 1990.

⁵ Unfortunately, this analysis has the disadvantage of not identifying the degree of value added as a result of exportation or the internal linkages involved. Thus, the method itself tends to exaggerate the importance of assembly activities. Assembly activities can undoubtedly contribute to the development of a country, especially in the first phases of exportation. However, their competitiveness will in the longer term depend on whether they are capable of integrating it increasingly into the rest of the economy, generating additional value added by taking advantage of "backward" and "forward" linkages. In 1988, the proportion of assembly activities in Mexico's exports to the United States came to 46%, while in 1990 in the Dominican Republic the proportion was estimated at two thirds of the total. For details on Mexico, see Wilson Peres, *Foreign Direct Investment and Industrial Development in Mexico*, Paris, Organization for Economic Co-operation and Development (OECD), 1990. For details on the Dominican Republic, see ECLAC, "Misión de apoyo a la reestructuración industrial en la República Dominicana", Santiago, Chile, Joint ECLAC/UNIDO Industry and Technology Division, 1991 (manuscript), and "República Dominicana: propuesta de programa de promoción de exportaciones", Santiago, Chile, Joint ECLAC/UNIDO Industry and Technology Division, 1991 (manuscript).

⁶ This group of countries consists of Brazil, Chile, Costa Rica, Greece, Israel, Norway and Uruguay.

⁷ This group is made up of Canada, Denmark, the Federal Republic of Germany, France, Italy, Sweden and Switzerland.

⁸ This group of countries consists of the former German Democratic Republic, Bulgaria, Czechoslovakia, Hungary, Malaysia, the Netherlands, the Philippines, Romania, the United Kingdom and the United States. Malaysia is exporting an increasing volume of non-natural-resource-based manufactures; if this trend continues, the country will soon enter the "rising-competitiveness" category.

⁹ This group consists of Australia, Ecuador, Indonesia and Paraguay. Australia, which is a developed country and an exporter of natural resources, is an example of an economy which is

showing signs of a lag in making its structure of production compatible with international demand.

¹⁰ This group consists of Argentina, Bolivia, Colombia, El Salvador, Guatemala, Honduras, New Zealand, Peru, Poland, the former Soviet Union and Venezuela.

¹¹ See ECLAC, *Las exportaciones latinoamericanas de productos básicos: cuestiones de política* (LC/G.1658), Santiago, Chile, International Trade and Development Division, 22 April 1991.

¹² Its other limitations include, in particular, its treatment of energy sources, whose lack of dynamism was largely induced by the price policy it advocated; underestimation of the physical expansion of sectors where rapid technical change resulted in a drop in their relative prices; failure to discriminate between exports with a high degree of internal linkage and those with few linkages (e.g., exports of assembly activities, which tend to make the situation of the Dominican Republic look more favourable than it is); the high level of aggregation used (three digits) and the failure to discriminate between genuine and spurious competitiveness.

¹³ For an analysis of policies in support of competitiveness in these areas, see ECLAC, "Changing production patterns with social equity: bases and dilemmas", *Changing Production Patterns with Social Equity*, op. cit.

¹⁴ In Europe, subsidies make up close to 10% of public expenditure. Half of this consists of donations basically aimed at capital formation. Tax exemptions or reductions, soft loans and shareholding are other noteworthy instruments of sectoral support. See Robert Ford and Wim Suyker, "Industrial subsidies in the OECD economies", *OECD Economic Studies*, No. 15, Paris, 1990.

¹⁵ See, for example, D. Okimoto, *Between MITI and the Market*, Stanford, California, Stanford University Press, 1989.

¹⁶ The priority which Japan has placed on the joint prospective effort between its government and private sector is clear from N. Makino's study published by the Mitsubishi Research Institute in Tokyo in 1990 and his study on the manufacturing sector also published in Tokyo in 1990 (Toyokeijaisinboshu).

¹⁷ See Bon Ho Koo, "Korea's Industrialization and Social Capability", and Linsu Kim, "Absorptive Capacity and Industrial Growth: A Conceptual Framework and Korea's Experience" (documents presented at the seminar entitled "Economic Growth

of Developing Countries: 1940's-1980's", organized by the Korea Development Institute and held at Seoul in July 1991.

¹⁸ Economic Commission for Asia and the Pacific (ESCAP), *Industrial Restructuring in Asia and the Pacific* (ST/ESCAP/960), Bangkok, 1991.

¹⁹ See ECLAC, *Changing production patterns with social equity*, op. cit., pp. 87 and 88. Experience also shows that such supports should be used in a highly selective way and should be gradually eliminated in the course of time. Better yet, they should be applied on the basis of export results in accordance with an *ex post* modality. See B. Song, *The Rise of the Korean Economy*, New York, Oxford University Press, 1990.

²⁰ The term "Latin American enterprises" refers to enterprises, the capital shares in which are, at least in their majority, owned or controlled by the citizens of the countries of the region. The quality of leadership varies from country to country, but is related to the absolute size of an enterprise and to its share in the market (a leading enterprise is usually among the four or five largest firms in each market).

²¹ Source: *Survey of Current Business*, "The international investment position of the United States in 1990", Washington, D.C., Department of Commerce of the United States, June 1991, table 7, p. 32, and Ned G. Howenstine, "U.S. affiliates of foreign companies: operations in 1988", *Survey of Current Business*, vol. 70, No. 7, Washington, D.C., Department of Commerce of the United States, July 1990, and Steve D. Bezirgianian, "U.S. affiliates of foreign companies: operations in 1989", *Survey of Current Business*, vol. 71, No. 7, Washington, D.C., Department of Commerce of the United States, July 1991.

²² These six studies were carried out as part of the UNDP/ECLAC regional project entitled "Design of policies to strengthen the capacity for technological innovation and enhance international competitiveness in the Latin American entrepreneurial environment" (RLA/88/039).

²³ Naturally, the difference in the size of the domestic market of the countries concerned is largely responsible for the continued existence of different styles of development.

²⁴ Social and political acceptance of such investments has been threatened by this failure to assess the situation. In some countries, access to information concerning enterprises is made difficult

by the fact that direct investment in the exterior is equated with flight of capital, the depletion of domestic savings and even with a lack of patriotism. Better information and assessments ensuring a certain minimal level of accuracy would not fail to help to eliminate some preconceived ideas which constitute a real barrier to investment in the exterior.

²⁵ See ECLAC, *La pequeña y mediana industria en América Latina: experiencias y potencialidades* (LC/R.661), Santiago, Chile, 1988.

²⁶ See, for example, Economic Commission for Asia and the Pacific (ESCAP), *Industrial Restructuring in Asia and the Pacific* (ST/ESCAP/960), Bangkok, 1991,

²⁷ See H. de Soto and S. Schmidheiny (eds.), *Las nuevas reglas del juego*, Bogotá, Editorial Oveja Negra, 1991.

²⁸ See ECLAC/UNESCO, *Educación y conocimiento: eje de la transformación productiva con equidad*, op. cit.

²⁹ See M. Porter, *The Competitive Advantage of Nations*, chapter XII, New York, The Free Press, 1990.

³⁰ In this connection, see ECLAC, "Los canales de comercialización y la competitividad de las exportaciones latinoamericanas", Santiago, Chile, Transport and Communications Division, July, 1991 (manuscript).

³¹ See ECLAC, *Structural Changes in Ports and Competitiveness of Latin American and Caribbean Foreign Trade* (LC/G.1633-P), Cuadernos de la CEPAL series, No. 65, Santiago, Chile, October 1990. United Nations publication, Sales No. E.90.II.G.10.

³² Operational costs relating to the port of Buenos Aires are estimated to be three times as high as those of Barcelona and Rotterdam and twice as high as the costs which prevail in New York. At recent meetings, Brazilian exporters have reported that barriers in port services constitute a pivotal problem where the competitiveness of Brazil is concerned. Chilean exporters estimate that insufficient investment in port infrastructure causes them yearly losses which are nearly as high as the cost of building a new dock.

³³ See ECLAC, *Información y telecomunicaciones: vector de la transformación productiva con equidad* (LC/R.1032), Santiago, Chile, 1991.

³⁴ The techniques associated with biotechnology and genetic engineering have made it possible to create new plant varieties which are resistant to different environmental conditions, in less time and at lower cost. This may alter the prospects for comparative agricultural advantages considerably, slowing international demand for certain farm commodities of importance to developing economies. An example of this is provided by the cane-sugar substitutes and by the production of vanilla extract. See A. Sasson and V. Costarini (comps.), *Biotechnologies in Perspective: Socioeconomic Implications for Developing Countries*, Paris, UNESCO, 1991.

³⁵ See ECLAC, "Reflexiones en torno a la agricultura latinoamericana en una economía abierta", Working Paper No. 13, Santiago, Chile, October 1991.

Chapter VI

INCOME AND THE PRODUCTIVITY OF LABOUR

1. Introduction

Since a large sector of the population derives the bulk of its income from its labour, the first step in any strategy for achieving greater social equity should be to increase employment and wages; in order for this increase to be sustainable, however, productivity will have to be raised as well. If labour income rises in step with productivity, then the objectives of social equity, competitiveness and stability can be compatible, since wage increases will not raise the unit costs of production.

There are three main means to this end. The first, and most classic, method is to achieve the full development of the labour force's latent abilities by means of training programmes conducted, in so far as possible, *throughout its members' working lives*. The second is to raise household income and national output through increased participation and the incorporation of the secondary work force (especially its female members) into the formal economy; this, in turn, would be accomplished by "socializing" the costs of some measures which, although they are intended to help women, actually hinder their entry into the formal sector. The third is to modernize labour relations, which would include the possibility of introducing performance-based wage systems or profit-sharing, as has already been done by a number of countries in the region. This not only raises productivity, but also reduces the marginal cost of labour inputs, thereby encouraging employers to hire more people. Both factors help to boost total wages. It

should be noted, however, that, in making an effort to maintain or increase the productivity of current or potential workers, care must be exercised to ensure that proper environmental conditions are maintained that will not jeopardize their physical or mental health.

2. Training¹

One of the most classic methods of raising the productivity of the workforce is training, which helps promote social equity as well as growth by, in most cases, leading to an increase in the wages of the workers in question.

Now, at a time when the region is called upon to thoroughly restructure and change its production patterns, training is of even greater importance than ever before, especially since high quality standards and competitiveness will play a fundamental role in this process. The modernization of production is not a smooth—much less integral—process but rather a course of action marked by tensions and imbalances in which human resources can fall out of step with new production requirements owing either to a lack of technical know-how or to an inability to adapt to a production environment that is changing more frequently and in more consequential ways. In order to narrow this gap, it will be necessary to provide dynamic training programmes for the labour force—not on a one-time basis, but throughout its members' working lives—as well as a better and more employment-oriented formal education.

In fact, the flaws of the current educational system (a subject that will be discussed in the chapter on investment in human resources) are in large part what determines the type of training that is needed, and will continue to do so for quite some time to come. Total and functional illiterates need basic remedial courses before they can benefit from traditional training programmes, while workers who have completed elementary school (slightly more than one-half) are, in theory, already in a position to do so. Because education and training are mutually reinforcing, they need to be broadened and upgraded simultaneously. A particularly determined effort is called for in regard to training, however, because it can be directed at the bulk of the present workforce and because it is an investment which has an unusually short lead-time, inasmuch as it begins to bear fruit almost immediately.

Numerous studies have been carried out in the region which corroborate the view that training is an extremely useful tool (although it is not yet known for certain what the most effective types and forms of training are).² An evaluation of vocational training programmes offered in Brazil (National Industrial Apprenticeship Service-SENAI), Colombia (National Service of Apprenticeship-SENA) and Chile (National Professional Training Institute-INACAP) which include apprenticeships, basic instruction and follow-up training has shown that their *social* rates of return vary but are in all cases appreciable (around 25% and in no case below 10%);³ of course, the rate of return to the individual is even higher (without taking into account the various externalities associated with training and education, whose net value can reasonably be assumed to be positive), since the State and business enterprises finance most of the direct costs of such programmes.

Despite their advantages, however, relatively few training activities are being conducted in the region. Only 2% of workers are attending courses in public vocational training institutes, and generally these courses are no more than 80-120 hours in length, which means that the State offers the equivalent of just

two weeks (full time) of special training per worker once every 50 years. Even assuming that private vocational training centres have a capacity equal to that of government-run institutions,⁴ *a typical worker will not receive more than four or five weeks' worth of training during his entire working life.*

Not only is there a shortage of training in the region, but —except in the case of programmes having specific social ends— what little training is available is primarily concentrated in large corporations. Indeed, these are the chief users of the tax exemptions provided to promote training (when any such exemptions exist, as they do, for example, in Brazil and Chile);⁵ large companies also spend several times more on training per worker than smaller firms do. Indeed, a study done in Mexico found that companies employing over 100 people spent three times as much on training per worker as did companies with less than 100 employees (in both cases the amount was extremely small, however: US\$30 and US\$10 per year, respectively).

If training is as important as the studies suggest, Why is so little training provided? Why do small and medium-scale enterprises, which employ the bulk of the labour force, do even less in this respect than large companies?

Even though the great majority of employers frequently bemoan the poor technical qualifications of their personnel, they do not feel they have a duty to provide training because they regard this as being the State's job. Indeed, the focus of traditional forms of human resource policy in the region is on the very short term, since businesses tend to adapt to immediate skill requirements rather than to the skills that technological progress will cause to be in demand in the future. This short-run perspective stems from attitudes that have their roots in the past, when there was not such a need to meet international quality standards because production was oriented towards the domestic market, and from the ingrained idea that vocational training, even of a specialized nature, is the responsibility of the State.

This traditional lack of interest in training tends to be even more marked in small and medium-sized businesses because this sector takes an even shorter-term view and fears that once a worker has been trained, he will demand higher pay or will leave the firm. Another factor is that, because the educational level of workers in such firms is usually lower, they derive less benefit from training, unless it is preceded by a basic refresher course in reading and arithmetic.

This lack of interest is also attributable to a conceptual distinction between two types of training: general training, which is useful in any place of employment (basic courses to help workers read instructions and blueprints or basic mathematics courses), and training which is specific to the company where a worker is employed. Strictly speaking, employers can be expected to be willing to train workers only in those tasks that are specific to their company, since only in those cases will they benefit from the worker's increased productivity without having to raise his wages substantially.

Companies will be reluctant to pay for general training, however, since although it raises a worker's productivity, that worker would then be more productive in any number of other firms as well, and could therefore switch to another company if he is not paid more for his higher productivity. Consequently, companies will offer much less training than what would be socially desirable, since they will not wish to provide general training; they will leave that type of training to the State or to the worker himself. Hence, another probable reason why small and medium-scale firms provide even less training than larger firms do is that many of the tasks and jobs involved in their activities are not specific but are instead common to all companies working in the same field.

a) *The promotion of active corporate training policies*

In view of employers' traditional aversion to providing training—to the point where they even fail to make use of the tax exemptions

available to those who do—serious consideration needs to be given to creating additional incentives for training to prevent the lack of skilled manpower from becoming so severe that it stops the countries of the region from gaining a better position in the international economy. Top and middle management need to be made aware of the benefits of training and to be informed about training initiatives in their sector and in the region.

At a more general level, public training institutions should redefine their role on the basis of the needs existing around them. For example, in cases where an ample supply of private training is available, public institutions can concentrate on controlling the quality of such training, training instructors and performing certification services. In cases where private institutes are not active in this field, however, public institutions should supplement the existing supply with their own efforts—whether in the form of home study courses, the preparation of instructional manuals or the establishment of technical assistance centres—with emphasis on general training programmes and assistance programmes for priority groups whose members would otherwise be largely neglected. Public institutions could be encouraged to be more responsive to their surroundings by authorizing the use of a portion of mandatory training contributions (if any) for the implementation of training programmes within business firms; this option has produced very good results in Brazil, for example.⁶

Another step that could be taken at the same time would be the incorporation of training into more general industrial programmes. For example, manpower training components could be included in loan or tax programmes designed to promote technological modernization. Consideration could also be given to ways of encouraging joint undertakings. Such ventures have two major advantages: first, they permit economies of scale in the implementation of training programmes that would be too expensive for a single company to carry out on its own; secondly, what is general training to one firm may be specific training from the

standpoint of most or all of the companies in a given field, and it may therefore make sense for them to finance training as a group so that they can internalize the benefits (at least so long as they continue to act as a group). In fact, there have already been cases where companies in the region have undertaken concerted training efforts in order to meet the quality standards required of participants in international markets.

One way of encouraging such initiatives might be to set up either sectoral or regional business management centres. These centres could facilitate a baseline analysis of problems and the proposal of possible solutions, as well as helping participants to profit from others' experiences as a group and promoting inter-firm cooperation. Public financing might be made available, as a supplement for private financing, for the start-up of such centres for a limited period of time (a definite deadline would have to be set, after which the centre would have to be financially self-sustaining).

b) *The generation and support of a demand for training in marginal or vulnerable sectors*

There are four groups in society which should, given their relative lack of organization and the magnitude of their needs, be targeted by training initiatives on a priority basis: people employed in small and medium-scale enterprises, people working in the urban and rural informal sectors, the unemployed, and unskilled recent entrants into the labour market.

i) *Small and medium-scale enterprise.*

Apart from the fact that they have fewer opportunities to provide specific training, which naturally limits their interest in this activity, there are a number of intrinsic reasons for small and medium-sized firms' reluctance to undertake training programmes, such as the fact that they benefit very little from the tax incentives designed to promote training and the fact that they cannot make use of economies of scale in training their personnel. This long-standing

reluctance could be overcome with the help of public-sector initiatives designed to familiarize employers with the advantages to be derived from training. Furthermore, personnel training could be included as an explicit component of an integral assistance package for small and medium-scale businesses which contains other elements that such businesses regard as highly valuable (e.g., quality control, marketing techniques, technological advances, etc.), as has already been done by a number of countries in the region.

ii) *The informal sector.* Training assistance for workers in the informal sector and in microenterprises will have to be undertaken on a much more permanent and active basis because this type of training is almost always general in scope and will therefore have to be not only promoted but also financed exclusively by the public sector.

There are three crucial elements in the design of these programmes, regardless of whether they are located in urban or rural areas. First, the training to be provided must be geared to these groups' actual capabilities and opportunities and should help to increase their incomes within the informal sector itself or to improve their employment opportunities in the formal sector; this will entail remedial instruction in the basic subjects required in order to benefit from subsequent training. Secondly, participants in such training programmes need to be given the opportunity to earn money during their training, particularly by selling the products they make in the course of the programme. Thirdly, the design of the programme needs to take into account the fact that it will frequently be necessary to provide scholarships or short-term credit for the purchase of materials, since these groups' incomes are too low to permit them to cover these expenses by themselves.

iii) *The unemployed.* It is important that the unemployed, and especially workers who have been laid off as a result of industrial retrofitting and whose skills correspond to sectors that are

in decline, should be provided with a kind of training that will enable them to rejoin the active workforce as soon as possible. This needs to be done swiftly because a long period of inactivity constitutes an added difficulty in terms of finding employment. It is particularly helpful if training programmes for unemployed persons include in-house training modules, since this provides a possible route to a more long-lasting position in the labour market (see box VI-1).

iv) *First-time entrants into the labour market.* Young people seeking work for the first time need to be provided with *bridges* between their formal education and the working world. This also suggests that there is a need to shift the focus of education, especially secondary education, so that it will be oriented more towards employment and less towards higher education. No matter how successfully this is done, however, first-time workers will always lack experience. Thus, it is important to provide various options for in-house training or internships to the great majority of young people who have just entered or are about to enter the labour market with few skills to offer potential employers. This would not only bridge the gap between formal education and the working world, but would also provide an attractive option to the vast number of young people who cannot or do not wish to go on to higher education or who do not have any contacts through which they could obtain a job immediately upon graduating from secondary school (see boxes VI-2 and VI-3).

c) *Opportunities for financially self-sustaining training*

Since workers themselves are among those who benefit most from training, many probably want the opportunity to finance their own training (general training, of course) rather than having to depend entirely on a company or the State to take the initiative. In fact, many workers—especially recent entrants into the labour market—are extremely interested in obtaining

training and are willing to pay for it in the private institutions which are found all over the region (for example, in Uruguay 40% of young people between 15 and 29 years of age have attended one semester or more of private training courses).

Once a worker is an adult and has family responsibilities, however, worker-financed training is not very feasible due to its double cost: the direct cost of the course, which may be prohibitive for a wage earner given the uncertainty of income levels that is typical of the region, and the indirect cost represented by the sacrifice of the worker's scarce free time in the evenings or of a portion of his income, if he leaves his job or reduces his working hours in order to attend training courses. The sum of these two types of costs may be too much for the worker, no matter how profitable such training may be in the long run. These obstacles could be overcome, however, by two means: first, the creation of a capital market on which loans could be obtained for investments in training and education; and secondly, the modification of labour laws to permit workers to take leave without pay for training purposes for a period equivalent to a specified number of man/hours every so many years. An effort will also have to be made to convince people that training is beneficial for both the company and the worker, since when workers take the initiative in seeking training, their decision is often received with indifference or even hostility by the companies for which they work.

d) *The costs of training*

The costs of a training programme at the national level will depend on its characteristics and scope. Nonetheless, increasing current direct expenditure on training by the equivalent of 1% of GDP seems to be a reasonable target; 0.5% of this amount would take the form of direct expenditures by companies, which would enable them to double the current level of training activities that they finance on their own, while the other 0.5% would go for high-priority

Box VI-1

RETRAINING FOR WORKERS DISPLACED BY THE RETROFITTING OF INDUSTRY IN MEXICO

Since 1984, the Ministry of Labour and Social Welfare of Mexico has developed a retraining programme for workers whose employment status has been affected by the retrofitting of the country's industrial facilities. Each year, intensive courses ranging from one to six months in length are given to an average of 40 000 workers; these courses provide instruction in specialized fields for which demand is expected to grow, such as accounting, automotive mechanics, carpentry, and the installation and maintenance of electrical systems.

This programme has been designed to serve as a temporary supplement for regular adult training programmes; one of its distinctive features is that it focuses on one specific target group: low-income unemployed workers, preferably heads of household, having an educational level which makes it feasible to train them as skilled or semi-skilled workers. At first, trainees were offered an income equivalent to one-half of the general minimum wage during the time they were attending the courses. Given the critical economic needs of the participants, however, this sum proved to be too low to forestall a high attrition rate. When the sum was raised to the level of the minimum wage, however, the drop-out rate fell to less than 10%.

Generally speaking, the programme has been a success. Between 80% and 90% of those completing the programme have found work, mostly in the formal sector. These workers proved to be welcome additions to the firms that hired them, and this, in combination with the growing shortage of semi-skilled technicians, paved the way for a cooperative effort by the public sector and employers which has led to the organization of jointly-run courses involving a period of formal training followed by in-house training in a participating firm. Under this joint scheme, businesses take part in designing the curriculum, setting entrance requirements and choosing candidates; they also pay a portion of the training costs and commit themselves to hire a given percentage (usually 80%) of the graduates.

public-sector programmes. At a cost of US\$500 per participant, this sum would make it possible to provide training each year for:

- 10% of workers in the informal sector and in small businesses in both urban and rural areas;
- 10% of small businessmen;
- 10% of public-sector employees;
- one-third of the unemployed; and
- the great majority of unskilled first-time entrants into the labour market.

If 10% or more of the labour force can be given training per year, then each worker would be involved in training activities an average of three or four times during his working life, thereby realizing the goal of life-long training.

3. Increased participation of the secondary labour force

Each household's income is determined not only by wage levels but also by how many of its members work. Since the labour force in Latin

America numbers about 150 million people and there are nearly 100 million households in the region, it may be assumed that an average of 1.5 members of each household form part of the workforce. Thus, household income could be greatly increased if other household members were to join the labour force. Obviously, this is especially important in the case of low-income households, where it may make the difference between living in poverty and having a tolerable minimum income.

Actually, for several decades now the participation rate of the "secondary" (i.e., non-heads of household) workforce has been on the rise. This is the net result of two trends: a decline in the participation rate of people in relatively low-productivity stages of life —i.e., young people (because they go to school longer) and old people (thanks to retirement plans); and a striking increase in the participation rate of women, particularly married women. In fact, the overall female participation rate doubled between 1950 and 1990, and today women make up 30% of the workforce of the region and have a

Box VI-2

A TRAINING PROGRAMME FOR YOUNG PEOPLE IN CHILE

In Chile, the National Training and Employment Service (SENCE) of the Ministry of Labour and Social Welfare has developed a vocational training programme for low-income young people who lack job experience. The programme will provide them with training and an opportunity to gain practical experience that will improve their employment prospects.

The aim of the programme is to address the problems posed by persistently high unemployment levels among young people and by the large percentage of young people who enter the labour market each year with no vocational training whatsoever. The training provided under this programme will primarily be intended to provide young people in marginal sectors who neither study nor work with their first opportunity to work in a company. Accordingly, the chief modality to be used by the programme is that of internships, whether as part of a work-study scheme or in the form of vocational instruction followed by a period of hands-on training. The programme also provides for two additional options designed for extremely disadvantaged young people and for those who are preparing themselves for self-employment.

The programme is expected to start in late 1991 with the help of IDB funding; its goal is to train 100 000 young people within four years. Participants are to receive a subsistence allowance for a maximum period of four months.

This programme also has a series of quite original features as regards financing and allocative mechanisms. First of all, the courses—which are to cover a very broad spectrum and to be wholly adaptable to local conditions—are to be taught by SENCE-accredited public or private training institutions which will submit bids for that purpose. The corporations which are awarded this responsibility will have the opportunity to modernize their equipment by means of leasing arrangements and will be eligible for special teacher- and instructor-training courses. Furthermore, the payment they will receive will be linked to indicators of the courses' successfulness. Upon a course's completion, the training corporation will receive 50% of the agreed value of the course and the remainder will be disbursed in accordance with student attendance and attrition rates and the subsequent job placement rate of the graduates.

Box VI-3

A DUAL-TRACK TRAINING PROGRAMME FOR YOUNG PEOPLE
IN THE DOMINICAN REPUBLIC

The National Technical and Vocational Training Institute (INFOTEP) of the Dominican Republic has organized a dual-track training programme with funding from the German Government. So far, three specializations are offered: industrial mechanics, automotive mechanics and cabinet-making.

A joint committee of experts and entrepreneurs in these fields determined the training needs on which the design of the programme was subsequently based. Participants in the programme are first given an eight-week course at the INFOTEP training centre, during which they are paid 40% of the minimum wage by the company where they will serve their internship. They then begin to alternate between four days of hands-on training in a company and one day of classroom instruction at INFOTEP. During this period their pay is gradually increased to 100% of the minimum wage.

During their internship in a participating company, their training is supervised by an INFOTEP-trained monitor. Upon completing two years of such training, the graduate is certified by an entrepreneurial board.

At present over 400 trainees are in the programme. About 90% of its graduates remain with the company where they completed their internship, and the programme has an excellent reputation among businessmen, who feel that the graduates of this two-track system achieve higher levels of productivity than those trained in secondary technical/vocational schools.

working-life expectancy of 20 years (as opposed to less than 10 years in 1950).⁷

This notable increase in the female participation rate is the result of many different factors, including: their higher educational level, which boosts their productivity in the labour market; their lower fertility rate and longer life expectancy,⁸ which increase the amount of time they have available for activities outside the home; and urbanization, which draws women away from rural subsistence activities and towards the job market, especially in the tertiary sector. (The services sector has high female employment rates and has been the fastest-growing sector in terms of job creation over the past 40 years.) These changes, in turn, have contributed to cultural change, since women no longer regard the home as their only possible sphere of action. Finally, the unemployment of the head of household or a sharp drop in the wages of the head of household during the crisis in the 1980s also led many women to seek employment. Nonetheless, the poorest households are the ones in which the fewest adult members of the household participate in the labour force.⁹ Furthermore, much of the increase in the female participation rate is accounted for by low-paying, low-productivity jobs in the informal sector, which has prompted at least one expert to talk about the "feminization" of the informal sector.¹⁰

Factors which help to restrict women's access to the formal sector, thereby limiting their employment options and participation, include certain non-wage costs which boost the effective cost to a company of employing women and thus discourage their hiring.¹¹ For example, some benefits (especially pensions and health care, in which benefits are relatively independent of the size of the contribution)¹² give rise to an undesirable differential between the cost of the manpower to the company and the value which the worker, especially in the secondary workforce, attributes to his or her total direct remunerations plus benefits. This

differential discourages hiring, at least in sectors with social security coverage.

There are two possible ways of solving this problem. The ideal solution would be to restructure benefits in such a way that they will be ascribed their full value by the worker (this has, in fact, been one of the reasons why some pay-as-you-go retirement pensions have been replaced with individual funded pension systems). The other possible solution would be to eliminate this anti-employment distortion by modifying the way in which benefits are financed so that they will be neutral as regards the use of factors rather than being tantamount to a payroll tax, as they are now. One simple method of doing this is to assess the employer's contribution to these types of benefits as a percentage of the value added by the company rather than of the payroll. If this is done, although the employer's *average* contribution will be unchanged, there will be a cross-company and cross-activity redistribution of costs: the most capital intensive enterprises will pay more than they currently do while the more labour-intensive enterprises will pay less; in this way, *employment and output* will expand without any increase in the amount of capital involved.

Even if these corrections are made, however, workers who are not heads of household¹³ (members of the secondary workforce) face other difficulties in connection with these benefits which hinder their employment. For example, the health care received by the household will not improve because a second member of the household pays into the medical insurance system. Thus, the secondary worker will not attribute a value to this additional benefit and will therefore not be willing to absorb its cost to the detriment of his or her wage level.

Another reason why non-heads of household usually prefer a higher liquid wage is because their discount rate is higher than that of a head of household (who does have longer-term family responsibilities). Consequently, employer contributions to retirement plans are another cost to the company that is not fully appreciated by secondary workers. Hence, the cost to the

company of such manpower and the value to the workers of their wages plus benefits do not match, and this hinders their employment.

In the case of women this situation is compounded by a series of additional costs which must be absorbed by companies that hire women, such as the provision of childcare facilities (if the number of women workers exceeds a certain level) and paid maternity (pre- and post-natal) leave. Although these benefits are of service to women employees, they raise the costs of *companies that hire women*; this discourages companies from employing women, at least in sectors covered by the social security system, and makes it more likely that women who participate in the labour force will have to do so in low-paying, low-productivity jobs in the informal sector which do not provide benefit packages.

In reference to the secondary workforce in general, consideration could be given to two types of methods of eliminating these obstacles, which both hinder participation in the labour force and promote the growth of the informal economy.¹⁴ One is to permit secondary workers to pay a smaller amount for health insurance if the head of that worker's household (the member earning the largest income) is already paying a sufficient amount into a medical plan. The other is to exempt the secondary worker from obligatory retirement plan payments if the head of household is already paying a large enough contribution to enable him to finance at least a minimum pension without State assistance; in the case of funded pension systems, the contribution could be deposited in the head of household's retirement account if the secondary worker so desires, rather than into a separate pension account.

As regards those specific benefits which make hiring women a less financially attractive proposition, the cost of such benefits should be distributed among *all* firms—as is done in the case of dependents allowances—in proportion to their value added, as suggested earlier, rather than requiring firms that hire women to shoulder the whole of the burden. In the case of childcare benefits, for example, all women workers with

small children—regardless of the number of women employees in any given company—would receive a voucher (from a fund established for this purpose using the contributions of each employer) with which to pay a day care centre or nursery school run by the public sector, the private sector or a non-governmental organization. A similar system could be used to finance the wages paid to women on maternity leave.

Such measures are just the first step, since they address only one aspect of sex discrimination in employment,¹⁵ that of the non-wage costs of hiring women in activities that provide social security coverage (although, actually, they apply to all workers other than heads of household). Despite their limited scope, however, the implementation of these measures would have a very beneficial effect in terms of both growth and social equity, since they would help raise the female participation rate and the employment of women in the formal sector. This, in turn, would increase the household incomes of the poorest groups in the population substantially, since the participation rate among the adult members of such households is very low at present. Indeed, the pursuance of an active policy to raise female participation rates in the region could boost women's working-life expectancy from the current 15-year figure to 28 years by the end of the century, according to ILO projections.¹⁶

4. Modernizing labour relations: profit-sharing schemes

Speeding up the generation of productive employment calls for substantial changes in labour relations. This involves, above all, respecting the right of the parties to defend their interests through collective bargaining, and in particular the right of workers to organize themselves in trade unions—a right which has often been restricted in the recent history of the region. Quite apart from the need to respect the minimum conditions for equitable collective bargaining, however, it is necessary to leave

behind the former tendency to look down on human resources and treat them as just another factor of production.¹⁷ Indeed, the current trends in many markets towards heterogeneity and diversification, together with the greater importance now attached to quality, have made this traditional type of organization of production less efficient. A vertical structure, extensively divided into separate compartments, may be just the thing for meeting homogeneous and stable demand on a massive scale, but it is too rigid to cope with a heterogeneous and changing market. Serving such a market and meeting the new demands for quality and diversification makes it necessary to give high priority to flexibility and quality control on an *ex ante* rather than an *ex post* basis. This is why the present trend in modern firms is to change centralized, vertically ordered production structures into decentralized, horizontally ordered ones with smaller production scales which make it possible to adapt production to the needs of changing demand, to raise levels of quality, and to mobilize the initiative, creativeness and spirit of responsibility of the labour force.¹⁸

Although markets in Latin America and the Caribbean have not necessarily evolved as radically as in the developed countries, they are moving in the same direction. Moreover, the growing importance of exports is a further reason why the new tendencies must be taken into account. Equally to the point, however, is the fact that smaller production scales and a more horizontal organizational structure are more in line with the demand characteristics of the present markets, which require production in smaller quantities, and they also help to save a scarce resource (highly specialized fixed capital).

An important consideration to bear in mind is that a worker's output—unlike that of a machine—is neither automatic nor a mere function of the time worked, nor does it depend only on the energy with which he fulfills his tasks, but rather on the intelligence he displays, his willingness to cooperate, and the team spirit created within the firm. This shows that it is

vital to modernize the relations between the employer and his employees, for as it is increasingly important to win the workers' support, it is necessary to see them as partners rather than as adversaries or as a mere factor of production.

The modernization of labour relations within the enterprise and the progress from confrontation to cooperation involve many elements, outstanding among which is the concept of participation. This extends all the way from participation in training, safety, health and welfare programmes to the establishment of quality and productivity circles, but in its central core it concerns mechanisms designed to link increased productivity with higher wages, the best-known system for this purpose being the payment of wages enhanced by a share in the profits ("profit-sharing"). This variation on the conventional way of paying workers, in which there have been interesting advances both inside and outside the region, not only improves productivity and hence wages, but also strengthens and speeds up the market forces conducive to full productive employment. For this reason, the system is doubly interesting for countries such as those of Latin America and the Caribbean, which suffer from such serious problems of unemployment, and above all underemployment.

At present, much of the labour force is paid for the *time worked* and not the *effort made and output achieved*. Consequently, workers have little incentive to show initiative (apply their intelligence) or make more than the minimum effort.¹⁹ Many empirical studies, however, confirm that—as common sense suggests—²⁰ payment by results can significantly raise labour productivity without extra investments in physical or human capital. In the fullest and most recent study on this subject, it is concluded that profit-sharing by the workers gives an increase in productivity of the order of 7%.²¹ It is also noted that this effect is further heightened if the workers not only have productivity-linked wages but also have a say or are habitually consulted on the day-to-day management of production activities.

Payment by results tends to raise productivity not only because it induces the worker to make a bigger effort —because his part in the improvement is now much clearer— but also because it reverses the social pressure, especially when the whole group are on profit-sharing: now it is his own workmates who want him to work harder, since if he works better all will gain, whereas if he does not they will all lose. Furthermore, by identifying the interests of the workers with the trading results of the firm and vice versa, the profit-sharing system usually improves the climate of labour relations. Finally, it also strengthens the social legitimacy both of the firm and of the changes demanded by the restructuring process.

Just as important as the foregoing, or even more so —especially in countries like those of the region which are affected by serious employment problems— is the fact that payment by results reduces the incentive to lay off staff and indeed stimulates the hiring of more employees. This is because on the one hand the labour costs of the firm are made more flexible, since any decline in demand automatically reduces the outlay on wages, and hence the incentive to lay off staff, while on the other hand the fact that the workers' wages are no longer fixed but depend partly on the income of the firm (sales, value of output, profits, etc.) encourages the latter to hire more workers.

The reason for this is that if *the whole* of the wages varied according to the profits of the firm, the marginal cost of labour (a given percentage of the added value, for example) would *always* be less than the marginal income derived from it (100% of the added value), so that in all cases the firm would want to expand and not to reduce its staff, under the same profit-sharing conditions.²² In the event that the whole of the wage were variable, it would not be the firm that would decide to hire fewer workers: the only reason would be that it might not be possible to find workers willing to accept the percentages of profit-sharing offered by the enterprise. After this point, if the firm wanted to hire more workers it would have to raise the percentages of profit-sharing offered, so that the

marginal costs of hiring such labour might exceed the marginal income (since it would be necessary to raise the shares of all the workers, and not only the new ones). In other words, the situation would be similar to that of commission salesmen, whom the firm has no incentive to dismiss even in the worst recessions: on the contrary, it usually wants to take on even more of them. The opposite occurs in the case of firms paying wages on a conventional basis, which stop hiring workers as soon as the marginal income falls below the marginal cost (the fixed wage).

Table VI-1 illustrates the effect of profit-sharing wages which causes the firm to always want to increase its staff on the existing contractual conditions, which of course does not occur in the case of a firm paying conventional wages. It can be seen from the example that with the same number of workers the economic situation of both firms is identical: individual wages are 15 000 pesos per month and profits amount to 1 million pesos. Their incentives for hiring an additional worker are very different, however. An additional worker would cost the conventional firm 15 000 pesos but would only generate 12 500 pesos of net additional income (line A5), so that the firm will not hire more workers. In contrast, the marginal cost of an additional worker for the firm paying profit-sharing wages is only 7 500 pesos (line C3), which is necessarily less than the marginal income of 12 500 pesos he generates (line C1), because by standing agreement the payroll only increases by part of the marginal income (60% in the example). The firm paying profit-sharing wages will therefore have an incentive to increase its staff. In view of the gravity of the current employment situation and its future outlook in Latin America, this benefit could hardly be overrated.

Naturally, the strategy of paying profit-sharing wages is not without its pitfalls. Quite apart from the possible decline in average wages, the expansionary effect on employment will be reduced if the older workers feel that their jobs are safe. In this case, they will begin to prefer higher basic wages —even at the risk

Table VI-1

EFFECT OF PROFIT-SHARING WAGES ON HIRING OF MANPOWER

(\$ = theoretical monetary unit)

A. Basic data

Price = \$ 5 000/pair of shoes
 Cost of materials = \$ 2 500/pair

<u>Number of workers</u>	<u>T=100</u>	<u>T=101</u>
A1. Level of production (Q)	1 000	1 005
A2. Gross income (PQ)	5 000 000	5 025 000
A3. Cost of materials	2 500 000	2 512 500
A4. Net income (value added = A2-A3)	2 500 000	2 512 500
A5. Marginal income per worker	15 000	12 500

B. Fixed wages

B1. Average wage = marginal cost	15 000	15 000
B2. Wage bill (B1.T)	1 500 000	1 515 000
B3. Cost of materials	2 500 000	2 512 500
B4. Total cost (B2+B3)	4 000 000	4 027 500
B5. Gross income (A2)	5 000 000	5 025 000
B6. Profits (B5-B4)	1 000 000	997 500

C. Profit sharing wages (assumption: wage bill paid = 60% of value added)

C1. Value added (A4)	2 500 000	2 512 500
C2. Wage bill (60% of value added)	1 500 000	1 507 500
C3. Marginal cost to firm (increase in wage bill)	15 000	7 500
C4. Profits (40% of value added)	1 000 000	1 005 000
C5. "Wage" per worker	15 000	14 900

of reducing the total number of jobs— because such wages benefit them directly, while the risk of not being taken on or losing their jobs will be run by the more recently recruited workers. Although this type of behaviour will restrain the growth of employment in boom periods, if a substantial proportion of the wages are on a variable basis the enterprise will at least keep dismissals to a minimum in periods of recession.

Thus, as may be seen from table VI-2, the most probable reaction of a firm paying wages on a conventional basis when faced with a crisis (a 10% drop in demand) will be to reduce both the number of workers and its level of production, while keeping its prices unchanged (alternative A), since in this way it will maximize its profits. In contrast, a firm paying flexible wages will face the crisis by lowering its prices in order to keep up or even raise its level of sales (alternative B), likewise in order to maximize its profits. This is possible because part of the cost of lowering prices is automatically shared with the workers: the average wage goes down by 6% (900 pesos) compared with the firm paying conventional fixed wages, but both the number of jobs and the wage bill will be greater (by 10% and 4.4%, respectively). What happens is that the traditional firm tends to make up for a drop in demand by reducing both its production and its labour force, and it will only start taking on workers again when the increase in unemployment has forced down real wages, which is a long and costly process. In contrast, the firm paying flexible profit-sharing wages arrives at this ultimate situation *directly*, without passing through the phases of reduction of employment and of production, since its workers' wages immediately adjust to the decline in demand and in the prices of the products, thus making it possible to keep up the levels of production and employment.²³ This is why it is considered that the latter system strengthens spontaneous trends in the economy (be they weak or strong) towards full productive employment.

The weak point in flexible profit-sharing wage systems is that the workers' income is

unstable because of variations either in their output or in the final price of the product. The latter is more serious, because it does not depend on the workers themselves. In compensation, however, they have greater labour stability than under the conventional system and above all, if profit-sharing systems spread, there is a possibility that their level of income will rise (either because of taking the risks involved in flexible wages or because of the higher productivity that this system usually generates).

As labour and income stability are real problems, the best form of contract for the workers, who are normally reluctant to take risks, would be one which reduces *both* risks to the minimum by making wages include both a fixed and a variable element. The use of this type of wage contract has become quite widespread in the developed countries,²⁴ especially in Japan, where the variable component represents a substantial proportion of the worker's total wage and is in fact the basis for the ability of the leading enterprises of that country to offer lifetime employment.

Although both theory and practice suggest that the increase in productivity, job stability and production justify the inclusion of a profit-sharing component in contracts, the extent of these benefits depends on how such components are worked out and implemented by each firm. For example, experience shows that the variable portion should correspond to at least 10% of the worker's income if major effects are expected to be produced on his productivity (as well as on employment, since labour stability is directly related to a size of the variable component in relation to the total cost of labour). Therefore, in systems such as those of Japan, South Korea and the Chinese province of Taiwan, where the variable portion of total income is significant (25%, 15% and 15%, respectively) it usually has a very positive impact on productivity; this does not occur even in those systems where workers own shares in the firms but obtain only a small proportion of their total income from this source.

Table VI-2

EFFECT OF PROFIT-SHARING WAGES ON MAINTENANCE OF FULL EMPLOYMENT DURING
CRISIS PERIODS

(\$ = theoretical monetary unit)

<hr/>				
<u>Pre-crisis</u>	Value of production	=	\$5 000 000	
	Value of materials	=	2 500 000	
	Value of labour	=	1 500 000	
	Profits	=	1 000 000	
	Average wage	=	15 000	
<u>Crisis</u>	Demand falls 10%			
<u>Type of contract</u>	<u>Fixed wages</u>		<u>Profit-sharing wages</u> (60% of value added)	
<u>Possible reactions</u>	A	B	A	B
	Constant price, Q falls 10%	Price falls 3%, Q constant	Constant price, Q falls 10%	Price falls 3%, Q constant
Value of production	\$4 500 000	\$4 850 000	\$4 500 000	\$4 850 000
Materials	2 250 000	2 500 000	2 250 000	2 500 000
Labour	1 350 000	1 500 000	1 350 000	1 410 000
Profits	900 000	850 000	900 000	940 000
Wage	15 000	15 000	15 000	14 100
Increase in unemployment	10%	0	10%	0
<hr/>				

Similarly, the system of payment should combine ease of understanding and calculation with economic efficiency. With respect to economic efficiency, the most important thing is not only greater productivity but also better quality and savings on materials and other related effects; in other words, making use of all the factors that affect profits more efficient. However, the more components a system of payment has and the more complicated it is, the more difficult it is for workers to understand the relationship between this indicator and their individual performance, and therefore the less effective it is as a genuine incentive to greater productivity. Thus it is important to involve workers in designing the system of payment, since if it is imposed on them and it is complicated, it might lack credibility. That is also why many firms decide to use some relatively simple indicators linked to profits but not profits *per se*; for example, in the case of salesmen, such indicators consist of the value of sales less the financial cost of accounts receivable; for manufacturing workers, their section's value added or high-quality physical output less rejects, multiplied by two or three, could be used; for truck drivers, the number of accident-free kilometres travelled or the difference between earnings from freight and operating costs of the vehicle could be used, and so on.

Finally, it is vital to decide at what level the incentives will be established. The efficiency of the incentives will depend on how closely they are tied to individual performances. Thus, salesmen's wages are very often established on the basis of their productivity, while in the clothing industry payment is often on a piecework basis. However, it might not be possible to apply such methods in modern factories where production is more complex and tasks are very interdependent, so that productivity is not attributable to individuals but rather to the collective whole. Moreover, administratively speaking, it might be complicated and expensive to calculate each worker's productivity in detail. Because of this, it might be preferable for the firm to provide

incentives for the performance of entire sections or departments instead of individuals. On the one hand, this might water down the incentive for individual workers and might lead to the problem of free riders, that is, workers who try to benefit from the increased efforts of others without putting in any personal efforts. On the other hand, however, it creates a "culture" of commitment to the firm and cooperation among workers in which group pressure generates greater productivity. In any case, the smaller the target group for the eventual bonus is, the greater will be the incentive.

The foregoing considerations indicate that a well designed profit-sharing wage system could be an important instrument for raising the productivity and income of labour without calling for substantial investment. This applies especially to the following cases: i) medium- and small-sized establishments or large firms whose functions can be divided into smaller economic units; ii) firms whose labour costs and labour productivity are particularly crucial to performance, or capital-intensive firms where the operator's carelessness or incapacity could seriously affect capital productivity; iii) tasks where the worker's performance could be significantly affected by the incentive established, especially tasks whose pace is not dictated by software technology (even though in this case the quality of work could suffer); and iv) when the worker's performance is affected by cash incentives (generally, the lower their level of income, the more sensitive they are to such incentives). That is why payment methods based on productivity are more common in developing than in developed countries, since developing countries usually have smaller firms (using more labour-intensive technologies), whose production processes are not as technology-intensive and whose labour force is not as well paid.²⁵

If productivity-based wage systems have the potential described above, and considerable interest in them has been aroused, why are they not —apart from piecework and sales commissions— in widespread use in Latin America and the Caribbean? One of the first

possible responses is that due to the low cost of labour, human resources have not been administered efficiently and used optimally. Second, it is only recently that profit-sharing wage schemes have been injected with fresh vigour as a result of renewed theoretical and empirical support. Third, one of the advantages of such schemes —the tendency towards full employment— is an *externality* for the worker, which means that if only *one* enterprise has a profit sharing wage scheme, employment increases but at the expense of the incomes of those already working; on the other hand, if *all* the firms put such schemes into practice, full and stable employment is generated as well as higher incomes for all. It was because of this externality that states should not only disseminate the idea of profit-sharing wage schemes but also promote it. In fact, in many developed countries, incentives have been established, including tax incentives, for the introduction of such wage schemes and, in particular, to give workers access to shares in the ownership of the firms.

The introduction of profit-sharing schemes could be especially beneficial in the region's present situation, both for keeping to a minimum any contractions in production and employment which might be caused by the stabilization and restructuring exercises now under way and for making them socially valid. Actually, it is precisely because they act *symmetrically* to make labour costs more flexible that their introduction would enable workers not only to share in the costs of adjustment or restructuring through a reduction in their earnings (something they are already doing), but also to participate unequivocally and directly in the benefits derived from such efforts on the basis of percentages laid down in the relevant wage agreements.

In addition, such schemes also help to meet the more long-term need of creating an atmosphere of growing cooperation, rather than confrontation, between capital and labour, leading to a more beneficial system of collective bargaining which has greater social advantages. Thus, profit-sharing makes a simultaneous

contribution to productivity (changing production patterns), employment (greater social equity) and social cohesion (democratization).

In any case, these profit-sharing schemes are arousing increasing interest in the region and are being applied with greater frequency (see boxes VI-4 and VI-5); a trend is also developing in which wage hikes are linked to cost reductions or increased productivity in collective agreements.

Measures which might be adopted to spread this idea and promote the profit-sharing option include the following:

First, since payments systems which provide for profit-sharing give rise to greater stability in employment, workers might be given the freedom, in a collective contract,²⁶ to swap part (leaving an unrenounceable minimum) of his legally established severance pay for a variable wage supplement calculated on the basis of some indicator of the enterprise's performance.

Second, consideration might be given to the possibility of authorizing a reduction in the rate of retirement benefit withholdings, for both workers and employers, amounting to that fraction of the workers' earnings which represents the profit-sharing component. This should not cause a significant drop in retirement benefits, since it is felt that the introduction of a profit-sharing system will increase productivity and hence the income of workers also.

Third, it might be feasible to institute a system whereby some workers, during the first few years they are employed and until they reach a certain age, could be remunerated solely on a profit-sharing basis. Profit-sharing schemes are likely to increase and give greater stability to the net employment of a considerable number of workers —the youngest of those in the established working-age group— who normally are the last to be hired and the first to be fired in times of crisis. It is therefore likely that such workers may remain under these payment schemes even after they reach the age of 25 (provided that guarantees have been given to them that their income will never be lower than

Box VI-4

CASES OF PROFIT-SHARING IN BRAZIL

In entrepreneurial and trade union circles in Brazil and in the Government, there is growing interest in wage systems based on profit-sharing. So great is the interest that the idea was incorporated as a law in the Constitution of 1988, and all that is now needed for it to take effect is the establishment of the regulations pertaining to it. Perhaps the most important consideration in this connection is that in the country interesting experiments have already been conducted in connection with profit-sharing, as illustrated by the following four cases:

In spite of the severe crisis of the 1980s, the firm Método Engenharia has recorded a rapid rise in its earnings, which have climbed from US\$14 million in 1979 to US\$170 million in 1989. Its progress has been so great and its management so notable that *Exame*, the leading Brazilian Journal on economics, chose it four times during the decade as the best enterprise in the construction sector on the basis of criteria relating to growth, profitability, productivity, liquidity and capitalization. This excellent performance is largely due to the profit-sharing facilities the firm makes available to its 2 500 workers. In addition to distributing 17% of its profits to its executives, heads of section and foremen, throughout the decade it has implemented mechanisms which allow its workers to participate in the management of the enterprise by increasing productivity and reducing costs. Thus, workers exceeding predetermined targets can receive increases in their earnings of up to 40% and even 50%. Thanks to this system, it has been possible to increase productivity notably and to reduce the rotation of labour to one third of the average for the sector. The Banco América do Sul is one of the 20 largest private banks of Brazil, with 133 branches and 8 900 workers. Since the 1950s, the bank has been carrying out a profit-sharing programme. In doing so, it is at present guided by the following two criteria: a branch's performance as measured by the strategic targets of the bank and the results of an individual evaluation of its employees. Thus, both individual and collective efforts are rewarded for meeting the objectives of the enterprise. In order to avoid favouritism or abuses of power, each worker participates in his own evaluation along with his immediate chief, but the final rating is determined at central level. In 1990, the employees received close to 21% of the profits, which meant that their incomes rose from between 8% and 20% above their annual wage.

SEMCO, S.A., an enterprise which produces industrial equipment, is applying an original profit-sharing system, which helped the firm to triple its sales during the 1980s in spite of the crisis. Every six months, more than 20% of the profits realized by each division is deposited in a special fund administered by the respective workers, who are free to decide what to do with it (sharing out of the money, purchase of shares, joint spending, etc.). The technical department of the trade union checks the data of the enterprise. In addition, in order to use the workers to the full extent of their capacity and identify them more closely with the enterprise, committees have been established for improving the physical environment of the factory area and facilitating communications between the employees and management through the intermediary of small groups designed to carry out specific tasks, with clearly defined objectives and action deadlines; mechanisms have also been adopted for joint evaluation of the enterprise (two or three times a year with the participation of all the employees) and of the immediate management (twice a year the employees give their opinions concerning their supervisors, who can be removed from their position for receiving an unfavourable rating too many times in succession) and for the selection of new chiefs (candidates are interviewed by their future subordinates). The wage scales of the enterprise are also prepared jointly.

This system of broad participation not only allowed SEMCO to show notable growth throughout the decade but also gave it the necessary flexibility —based on competence and participation— to cope with periods of recession and high inflation by reducing its payroll costs through the creation of satellite assembly activities made up of former workers whom SEMCO supplies with equipment and financing.

Finally, perhaps the oldest system of participation in Brazil is that operated by the Ipiranga Group, which introduced it in 1937 when Ipiranga was only a small petroleum refinery in Rio Grande do Sul. Today it is a conglomerate of 27 enterprises with annual sales amounting to nearly US\$3 billion, which has made it one of the country's largest private petrochemical firms. Every year its workers receive 3% of its profits under its profit-sharing system, which allows those who earn higher wages to increase their incomes by 4% and those with the lowest base wages to increase their earnings by up to 16%.

Source: ECLAC Office in Brasilia, on the basis of interviews and press clippings.

Box VI-5

PROFIT SHARING IN CHILE

In addition to individual incentives, such as special treatment and sales commissions which have always existed, in many enterprises (close to 20% of those in the formal or modern sector) incentives related to the productivity of the firm as a whole also exist. In these cases, production bonuses and/or profit sharing, over and above that required by law, represent close to 15% of the income of workers. The following three cases are examples of the application of these systems and their effects.

SODIMAC, S.A., a building materials firm employing 1 000 people, has initiated a broad system of incentives which vary depending on the type of job. Sales personnel, who account for the majority of the firm's staff, receive a percentage of the sales they make, which rises in proportion to the margin of profit of the product sold, from which is deducted a certain amount for losses (in the case of those who work in stores), sales costs and the cost of financing accounts receivable (in the case of off-premises sales personnel). Thus, not only are incentives given in respect of the most profitable products, but cost savings are also encouraged. This variable proportion represents a high percentage of the earnings of the employees, fluctuating between 30% and 150% of the base wages paid and averaging out to 80%. In this way, it has been possible to increase sales, serve customers more effectively, promote cooperation rather than competition among the sales personnel of each outlet and reduce the number of uncollectable accounts and the length of credit periods in the case of external sales.

The central managerial staff receives a bonus calculated on the basis of the profits made, which, on average, raises their income by 25% a year. Although the bonus does not in itself result in greater productivity, because it represents income which varies on the basis of the firm's performance, it makes costs more flexible, thereby contributing to greater job stability.

The Marmentini and Letelier supermarket chain has also adopted an extensive system of incentives for its whole staff, which is tied to the "profitability" of each department rather than to sales alone. For example, the meat section receives a percentage of the difference between its sales and its purchases (which promotes increased sales and encourages workers to make the best use of the various cuts of meat as well as favouring savings on purchasing costs, reducing waste and cutting losses). Similarly, truck drivers receive a bonus in proportion to the difference between the income received per load minus the expenditure on each vehicle plus an additional bonus if no accidents are incurred. Employees working in the garage are given incentives designed to increase the durability of their work and keep costs to a minimum. With this system, it has been possible for the workers to identify with the interests of the firm and to bring about a significant rise in the degree of worker supervision and cooperation. Thus, drivers look for the shortest routes and the cheapest gas and try to avoid accidents. Mechanics try to produce durable work, to find inexpensive materials of good quality and to identify drivers who do not take good care of their vehicles.

Finally, the Compañía Manufacturera de Papeles y Cartones (paper and cardboard manufacturing company) is an example of another kind of relatively far-reaching group incentives. At its Puente Alto plant, which employs 1 000 workers, incentive bonuses are calculated on the basis of the percentage by which the pre-established production target was exceeded in one shift, with a deduction for rejected products. In this way, impetus is given to productivity while still taking quality into account. It is generally agreed that these incentives have a considerable effect on productivity. Teamwork is promoted —when a machine is not operating well, everyone helps to put it right so that the production process is not interrupted. In addition, the workers themselves invent ways of producing more or of cutting down on the length of time between the different stages of production.

All these examples demonstrate the effectiveness of profit-sharing schemes in raising individual and group productivity through closer identification of the interests of workers with those of the company employing them; this also makes the company's wage bill much more flexible. However, it also happens that those already employed tend to want to absorb increases in the demand for labour through their own efforts instead of seeing the enterprise hire more labour. In addition, at the microeconomic level at least, because these schemes reduce labour instability in periods of recession without being overly expansive in boom periods, they have a cushioning effect on economic cycles; as for their expansive effect on employment, it will be felt only when their application is sufficiently generalized.

Source: David Bravo, "Los salarios participativos y su efecto sobre la productividad del trabajador y la estabilidad en el empleo", *Colección Estudios CIEPLAN*, No. 29, Santiago, Chile, Corporación de Investigaciones Económicas para Latinoamérica (CIEPLAN), September 1990.

the minimum wage), which would also benefit the economy as a whole.

In addition to encouraging the introduction of profit-sharing, these three incentives have the merit of being voluntary (rather than being imposed by law) and of having no implications in terms of fiscal expenditure. Their disadvantage lies in the fact that, because they are voluntary, they would be adopted only gradually. Moreover, since the beneficial effects of the mechanisms on employment in general constitute an externality where enterprises are concerned, their full potential would not be realized.

More radical proposals, aimed at universalizing the use of profit-sharing mechanisms, could be considered in order to reach full productive employment more quickly. One step in that direction would be to establish legally that a certain portion (which could represent up to 50%) of the *increases* in real wages—at least of workers in firms with collective contracts—must be based on some form of sharing (whether of profits, sales, value added or production), until a significant percentage (25%, for example) of the worker's income would normally come from variable sources. New workers would be hired from the beginning with a set proportion of their variable income as a target figure. Thus, over a period of 10 to 20 years a considerable part of the income of wage-earners in the total workforce (or at least of the sector whose contracts allow for collective bargaining) would be derived from their participation in the performance results of their firms, which would have a positive impact on productivity and, in particular, on employment. In any case, any change in the wage system would require social consensus in order to ensure its feasibility.

Profit-sharing and having a voice in company management are not the only possibilities for participation. An important potential exists at the macrosocial level: the opportunity to use *social consensus-building* to seek solutions based on cooperation among the various economic agents for the good of the community as a whole. Indeed, as noted in the

chapter on economic stabilization, each individual agent tends to defend himself as far as possible with the tools available, even though it is obvious that if everyone acted the same way, the common good would not be served. Since the tools available are generally microeconomic ones—raising prices in the case of the entrepreneur, pressing for higher wages in the case of the trade union, and so forth—the spontaneous action of each social actor contributes to the failure of the stabilization programme, and does not improve anyone's situation. Unfortunately, although all the agents realize the effect of their actions, it is impossible to avoid them at the microeconomic level. In fact, self-discipline and refusal to demand a wage increase (or price rise) higher than the inflation rate targeted by the government contribute only minimally to the achievement of this objective; on the other hand, the agent runs the risk of an abrupt drop in income if the other agents fail to change their own expectations. This is why no social agent has any microeconomic incentives to support the stabilization programme and, in such circumstances, even the best plan is doomed to exceed the inflation target and, if the government persists in its attempts, to face a recession.

These considerations explain the argument in favour of social consensus-building, this being a means of permitting each agent to opt for an ideal solution—for example, reducing inflation—by renouncing the improper use of the available microeconomic tool in exchange for a promise that all the other agents will do the same. Thus, not only is it agreed to keep price and wage increases within certain limits, but the government is asked to ensure that this is actually done. Thus, consensus-building leads to cooperation as well as control. The monetary, fiscal and exchange measures which the government promises to adopt form part of the agreement, since no stabilization programme can have lasting effects if it is based only on agreed prices and wages. Moreover, few social agents will accept self-discipline without first having assurances that the

government will also contribute to the programme's success.

Consensus-building can also be a powerful tool for reaching social agreements of broader scope on especially conflictive matters. Examples of this type of consensus include tax reform and social spending programmes or plans to restructure and modernize the State apparatus, whose adoption would require the support of broad coalitions, involving many "political" exchanges among the social actors, since they affect powerful interest groups and involve important distributive changes. When such agreements are finally reached, they have the advantage —unlike decisions imposed unilaterally by the executive power or even those adopted by the legislature— that the social agents' participation in them gives them legitimacy and thus makes them more stable.

5. Environmental conditions favourable to labour productivity

It is well known that the physical environment surrounding the worker has a significant influence on his output, and thus on his productivity. One of the main factors of the physical work environment in this sense is occupational safety and health. Poor conditions in these areas lead to a deterioration in productivity for various reasons: they cause on-the-job accidents and consequent absenteeism, and such accidents entail payment for work not done, as well as medical and compensatory payments. They can also cause damage to equipment and materials, delays in production and other indirect losses. Moreover, poor environmental conditions can lead to illnesses which eventually become chronic, with the resulting decline in the worker's output and reduction of his useful life. Lastly, such conditions affect worker morale and motivation and result in poor-quality output.²⁷

A great deal of past experience —mainly in firms in the industrialized world and their affiliates in the region— suggests the need to provide within a system of participation and

consensus-building, practical facilities such as the following:

a) Facilities to ensure an adequately healthful work environment (toilet facilities, drinking water, safe areas for changing clothing, washing facilities, etc.);

b) Facilities to alleviate or prevent on-the-job fatigue, depending on the characteristics of each type of work;

c) Facilities such as nurseries and child-care centres which, although not directly linked to the work environment as such, foster greater tranquility among workers, especially female workers.

Despite their undeniable importance, the foregoing elements reach only one relatively poor segment of the population, composed of workers employed mainly in the most modern sectors of the economy. The environmental issue, now associated not only with the most immediate workplace but also in general with the surroundings in which the worker lives, affects to a greater or lesser extent the output and productivity of the poorest groups.

One illustration of this phenomenon is the increase in the number of victims of malaria during the 1980s, partly as a result of poor environmental conditions, including overcrowding and lack of hygiene in human settlements, dwellings which allowed mosquitoes to enter easily and ponding of water around these dwellings. No less serious is the situation with regard to intestinal diseases, also caused by poor sanitary conditions, lack of access to drinking water or failure to treat this water. These conditions are reflected in the excessively high morbidity of the poorest sectors, which weakens their capacity to work, often permanently.

As a consequence of the outbreaks of cholera recently, there has been a consensus on the need to take emergency steps to limit the severity of the epidemic in the region and alleviate its effects where the disease is present. This requires a medium- and long-term programme to attack its underlying causes and eliminate risks (and, in so doing, solve a good many of the intestinal problems which have

affected the poor sectors of the region for so long). The medium- and long-term programme would require that three critical environmental deficiencies be overcome in the region through the following actions: repair and complete protection of existing water supply and sanitation systems; extension of the drinking water supply network, treatment of waste water and expansion of coverage of garbage disposal systems; and strengthening of national and local health systems.

Notes

¹ The subject of training is explored in greater detail in the study on which this section is based. See Economic Commission for Latin America and the Caribbean (ECLAC) and UNESCO Regional Office for Education in Latin America and the Caribbean, *Education and Knowledge: The Basic Pillars of Changing Production Patterns with Social Equity*, Santiago, Chile, ECLAC/UNESCO, 1992.

² The most controversial issue in this connection is the evaluation of the relative yield of the various modalities of training and instruction, e.g., whether it is preferable to have instruction in the schools followed by a short period of on-the-job training or to have a longer period of instruction in technical or vocational schools.

³ See Inter-American Research and Documentation Centre on Vocational Training (CINTERFOR), *La formación profesional en el umbral de los 90. Un estudio de los cambios e innovaciones en las instituciones especializadas de América Latina*, vol. 2, Montevideo, 1990, table VIII.2.

⁴ In some countries incentives are provided to encourage private institutes and companies to conduct training programmes, but this is unlikely to alter the above situation in any substantive way. For example, a study carried out in Mexico found that although in-house corporate training programmes reach a larger number of workers than outside programmes (slightly more than 10% of the labour force), the length of such courses is much shorter (less than 10 hours), which is equivalent to providing 100 hours of training annually to 1% of the workforce. See Dirección General del Empleo y Capacitación Profesional de México, "Investigación sobre necesidades de

capacitación", Mexico City, 1976, table 17 (unpublished).

⁵ In Brazil, one study of the use of tax incentives for training programmes found that no more than 7% of the possible exemptions had been used by just a fraction of small and medium-scale firms, and therefore concluded that their effect was quite limited and highly concentrated. See Inter-American Research and Documentation Centre on Vocational Training (CINTERFOR), *op. cit.* In Chile, 15% of the available exemptions are used, but this figure is still quite low; in this case too, the exemptions were concentrated in the largest companies.

⁶ The reduction of their compulsory financing has motivated public training institutes in Brazil to try to be more flexible, and this, in turn, has led to greater participation on the part of employers and trade unions in activities associated with an increase in productivity.

⁷ The statistics probably underestimate women's actual participation, since women often perform economic functions which are not remunerated and therefore are not figured into the labour participation rate. This occurs especially in rural areas, where labour on one's own farm is not counted as participation in the workforce.

⁸ Over the past 40 years, women's average fertility rate has declined from nearly 6 children per woman in the 1950s to slightly over 3 children per woman at present. In addition, women's life expectancy has increased by 15 years during this period. Thus, the fact that women are living longer and having fewer children greatly increases their opportunities to seek employment. See J. Chackiel, "América Latina: Notas sobre la dinámica de la población. Período 1950-2000", Santiago, Chile, CELADE, 1990 (unpublished).

⁹ In fact, various studies have shown that the factors that play a part in determining whether a household is or is not poor include both a higher rate of unemployment and the participation of fewer household members in the labour market in general and in formal-sector employment in particular. See, for example, M. Pollack, *Pobreza y mercado de trabajo en cuatro países: Costa Rica, Venezuela, Chile y Perú*, Working paper series, No. 309, Santiago, Chile, PREALC, 1987, and A. Uthoff, *Interrelaciones entre población y desarrollo: bases para políticas de población en el Istmo*

Centroamericano, Working paper series, No. 339, Santiago, Chile, PREALC, 1987.

¹⁰ See V. Tokman, "Policies for the heterogenous informal sector in Latin America", *World Development*, vol. 17, No. 7, July 1989.

¹¹ Women face other much more serious employment problems than this, of course, including *sex discrimination* in the labour market in terms of hiring, segmented access to certain types of occupations, unequal pay for equal work, and discriminatory treatment as regards training and promotions. All these problems need to be addressed systematically on an ongoing basis. This discussion is concerned only with obstacles to the hiring of women. For a comprehensive examination of sex discrimination in the labour market and approaches to dealing with it, see ECLAC, *Women in Latin America and the Caribbean: The challenge of changing production patterns with social equity* (LC/L/627(CRM.5/4)), a paper presented to the Fifth Regional Conference on the Integration of Women into the Economic and Social Development of Latin America and the Caribbean, Curaçao, 16-19 September 1991.

¹² Non-wage costs, such as payments corresponding to holidays, vacation days, fixed weekly payment levels regardless of the hours actually worked, Christmas bonuses, etc., are exactly equivalent to larger cash payments; they do not alter the final cost of hiring a worker, however, because they are fully absorbed by the worker in the form of a lower daily wage. Much the same thing happens in the case of dependents allowances, which, as a rule, do not influence the total cost of labour, since they redistribute income among workers but do not redistribute it between capital and labour.

¹³ This argument applies only to non-heads of household, whether they are men or women. A woman head of household will value these benefits just as much as a male head of household will.

¹⁴ These proposals, as well as the list of types of discrimination that need to be addressed, are based on a paper by Francisco León entitled "Familia, trabajo y política de ingreso, escenarios emergentes", which was presented at the Workshop on the Family, Development and Population Dynamics in Latin America and the Caribbean", organized by CELADE and the ECLAC Social Development Division in Santiago, Chile, in November 1991.

¹⁵ A more comprehensive programme to reduce sex discrimination in employment and thereby

increase women's incomes and participation rates would require an array of specific policies directed at both labour demand and supply. These would include the introduction of flexitime; the promotion of part-time jobs (by, for example, allowing businesses to set their own hours and eliminating the requirement that shops be closed Saturday afternoons); the extension of school hours, especially in low-income neighbourhoods, in order to provide study halls for doing homework and supervised care for children during working hours; pre-school education; maternal welfare services and maternity and child health care; the provision of greater access for women to what have been almost exclusively male occupations, access to training for such occupations, etc. See ECLAC, "Women in Latin America and the Caribbean...", *op. cit.*

¹⁶ See Shirley Nuss, *Women in the World of Work. Statistical Analysis and Projections to the Year 2000*, chapter 6, Women, Work and Development series, No. 18, Geneva, International Labour Office, 1989.

¹⁷ This attitude to human resources is usually known as "Fordism", as it was Henry Ford who created the concept of mass production based on the division of the production process into a series of simple tasks.

¹⁸ The trend towards decentralization is also leading to greater use of subcontracting. Modernizing the relations between big firms and their subcontractors is another important element in improving productivity and equity. To this end, some firms in the region have begun to develop support networks in the areas of technical assistance, training and planning, aimed in particular at subcontracting firms with which they have regular production relations. The purpose of these networks is to ensure quality, enhance reliability, and improve the subcontractors' adaptability to shorter technological and product cycles.

¹⁹ Of course, payment for time worked does not completely eliminate the link between wages and productivity, for certain minimum levels of effort are always demanded and both promotion and dismissal depend on the worker's performance. Nevertheless, the effect of such measures is at best an imperfect substitute for the advantages obtained by linking wages to productivity.

²⁰ See, *inter alia*, the studies assembled in A. Blinder (ed.), *Paying for Productivity: A Look at the Evidence*, Washington, D.C., The Brookings

Institution, 1990, and the many references made therein.

²¹ See M. Weitzman and D. Kruse, "Profit Sharing and Productivity" in *Paying for Productivity: A Look at the Evidence*, Alan Blinder (ed.), Washington, D.C., The Brookings Institution, 1990. This book summarizes the results of over 200 detailed case studies of firms which apply profit-sharing schemes, six studies giving the views of staff working in over 200 firms of this type, 15 studies giving the views of the executives of over 4 000 firms, 16 econometric studies on almost 5 000 firms in Germany, France, Italy, the United Kingdom and the United States, and an analysis of the production bonus system used in Korea and Japan.

²² In practice, this effect is not so marked when only part of the wage is variable and the remainder corresponds to a basic wage, or when the labour market is segmented, with distorted prices and power relations and unequal bargaining power, as is usually the case in the region. The important thing is that wages based on a profit-sharing system point in the right direction. Thus, the higher the variable component, the greater the possibility that the marginal cost of hiring workers will be less than the marginal income produced by them, thereby encouraging the firm to hire more workers on the same terms of fixed and variable payment.

²³ In a graphical representation of the adjustment process, for the case of a firm paying wages on a conventional basis the labour supply curve for the firm *in the short term* is horizontal. Consequently, in order to adapt to changes in product demand it must change the amount of labour hired. In contrast, the use of flexible profit-sharing wages causes the labour supply curve *in the short term* (i.e.,

the workers currently employed) to be vertical, at least in the section of interest to us here. Consequently, a firm using this system can face up to drops in demand by reducing product prices and the workers' wages rather than by reducing the level of production or employment. Finally, it should be noted that what changes in line with the form of wages paid is the *short-term* labour supply curve (i.e., those currently employed). The *long-term* labour supply curve remains the same in both cases, assuming that it is all the same to the worker whether he has an unstable job at fixed wages (the conventional system) or a job which pays flexible wages but gives greater stability of employment (the profit-sharing system).

²⁴ Indeed, as recently as the early 1960s as much as 60% of the industrial labour force in Sweden, the United Kingdom and the Netherlands was employed under some form of payment by results, although since then this proportion has gone down, partly because of the spread of technologies where the process itself conditions the rate of work.

²⁵ However, for these very reasons, the workers might be less inclined to take risks and therefore might desire steadier income. The values attributable to such variation in income and to greater job stability should be compared, since reluctance to take risks includes both components.

²⁶ Our insistence on confining swaps of this sort to collective agreements stems from our recognition that the inequality between an enterprise and an isolated worker in negotiations is so great that allowing such exchanges at the individual level might be very prejudicial to the worker.

²⁷ International Labour Organisation/United Nations Environment Programme: *Employers and the environmental challenge*, Geneva, 1986.

Chapter VII

SAVINGS AND THE PRODUCTIVITY OF CAPITAL

1. Introduction

In *Changing Production Patterns with Social Equity*, emphasis was placed on the importance of the following factors in strengthening capital formation in the countries of the region: i) an increase in national saving and a reduction in negative resource transfers; ii) the implementation of macroeconomic policies that are in keeping with the objectives of stability and growth; and iii) the development of sound, competitive financial systems and capital markets.¹ Assuming that basic macroeconomic balances have been restored and that they can then be maintained within tolerable limits, the following discussion will focus on the other two factors, which are of decisive importance in the longer term.

One of the most formidable obstacles to full productive employment in developing countries is a shortage of capital, which is further aggravated by the concentration of wealth and the fact that the scant supply of capital that does exist is not very mobile either between activities or between firms. Consequently, the bulk of this supply is concentrated in just a few activities and companies, while the rest must use overly labour-intensive, low-productivity technologies. The result is an excessively heterogeneous production structure, which tends to waste what little capital there is, to reduce competitiveness and to diminish employment opportunities in more productive jobs. Therefore, any measure that boosts saving or improves the allocation of

investment will be beneficial both in promoting growth through an increase in productivity and in terms of social equity, since it will augment the effective supply of capital, which is at present the scarcest factor of production.

In order to raise saving and the effectiveness of both intermediation and the allocation of investment capital, a policy of financial deepening and complementarity is required that will increase saving on the part of the entire population and make the capital market accessible to large groups of companies, activities and types of investment that are virtually excluded from this process at the present time. It is a fact that established financial institutions display a marked preference for dealing with large-scale commercial and industrial enterprises located, as a rule, in urban areas. This is true not only of developing economies; in fact, the existence of such gaps and biases in developed economies is what prompts them to create institutions for dealing with needs that are not adequately met by the existing financial system.²

Financial liberalization alone —if confined to just one segment of the market and unaccompanied by measures to fill those gaps, promote capital deepening and correct the capital market's segmentation— would fail to take full advantage of potential saving and would allocate investment inefficiently and inequitably. In the worst of cases, concentration introduces an element of fragility into the capital market, spurs speculative and short-term operations, and

fosters a tendency towards capital flight, overborrowing and insolvency.

Emphasis is being placed in this chapter on practical methods of boosting saving on the part of wage earners and of improving the operation of the capital market not only because of the obvious relationship between a smoothly operating capital market and changing production patterns, but also, above all, because of the importance of a well-run capital market in promoting greater social equity. Indeed, one of the basic tenets of this document is that the problem of unemployment and underemployment is caused less by rigidities in the labour market (which do, however, exist and will have to be reduced) than it is by flaws in the capital and land markets. As a result of the imperfections, segmentation and gaps in the capital market, capital—which is already in short supply as a consequence of low saving rates—becomes even more scarce, thereby jeopardizing growth and the creation of productive jobs. This is why means are being proposed of creating an investment market that would provide small and medium-scale enterprises with genuine access to long-term capital and of promoting and upgrading the land market.

In view of the close interdependence of investment and productive employment, it is imperative that an effort be made to increase saving, especially since pressures are being exerted in the opposite direction.³ Although the setting of interest rates at realistic levels is one of the steps which must be taken in order to bring about a substantial increase in saving, the most important measures in this connection are of an institutional nature. For reasons of social equity and efficiency as well, an effort must be made to raise the extremely low saving rates of wage earners. Hence this document's emphasis on measures such as compulsory savings mechanisms which would be linked to the social security system, as well as incentives for saving aimed at achieving significant improvements in areas of special interest to the lower-income segment of the population, such as better housing and education.

It should be noted that all the above are examples of *institutional* measures which call for an *active* public policy designed to promote growth and social equity.

2. The need for workers to save more

As a consequence of the crisis, gross capital formation in the region has fallen by six points to less than 17% of GDP. In order to regain the levels recorded in the 1970s, and thereby make it possible for production and productive employment to grow on a sound, sustained basis, it is clear that a very significant increase in national saving will be required. Moreover, the region's increasingly severe environmental problems (erosion, soil depletion, the pollution of rivers and coastal zones, air pollution, and many others) demand that savings be of a sufficient level to finance not only a return to the levels of gross capital formation seen in the 1970s, but also the repair and prevention of this type of damage to the region's "natural capital" so as to ensure that the development process will be both sustainable and equitable. This is why, as noted earlier, emphasis is being placed on the need to achieve macroeconomic stability, to send out signals in the form of suitable prices and incentives that will open up profitable investment opportunities (as a means of raising corporate saving) and to alter fiscal policy so as to eliminate fiscal deficits and, eventually, boost public saving once again.⁴ It is worth taking a moment here to look more closely at the subject of personal and household saving, which is an often overlooked but nonetheless considerable potential source of capital and is, moreover, particularly important from the standpoint of social equity. This type of saving affects the level of social equity in two ways, in that it not only speeds growth and raises productive employment—as other types of savings, when wisely used, tend to do as well—but also ensures that it will be the workers themselves who will receive the financial flows to be derived from these savings in the future, thereby

eventually increasing workers' incomes and improving the distribution of income.⁵

The available information indicates that individuals and households, *even in low-income groups*, are willing to save—not as a means of obtaining a high interest rate (although it should be positive)—but in order to gain access to services or funding that will permit them to carry out profit-making projects or ones they regard as highly important.⁶ These "projects" may consist of obtaining financing for the purchase of a house, in some cases, or of paying for professional training or higher education for themselves or their children. Similarly, in order to persuade these groups to save more, it is more effective to ensure them an adequate, steady return on their savings than to offer them high interest rates. These mechanisms will be discussed below.

a) *Institutional saving by workers*

Social security retirement plans can perform two basic functions: a *social function*, by maintaining people's income levels during their old age, and an *economic/financial function*, by serving as a means of mobilizing domestic saving and investment financing. Although the chief objective of these systems is the performance of the above-mentioned social function, they can also be used, without sacrificing this goal, to increase saving.

Making it mandatory for individuals to pay into such a system (compulsory saving) during their working years in order to meet their consumption needs during their old age *assigns the State a fundamental responsibility* for the design, stability, solvency and organization of that pension system. The main argument put forward in the countries of the region to justify compulsory forms of saving by workers (institutional saving) is the "short-sightedness" of many families when it comes to decisions about saving or, in other words, their failure to plan ahead so as to ensure themselves a certain income level during their old age or to consider the outcome of discounting future income at

interest rates that exceed the social discount rate. If such short-sightedness does indeed exist, then the portion of workers' social-security contributions that are used to finance pensions can help to boost national savings.⁷ The precise nature of the impact on savings will depend on the type of retirement system in use. There are basically two types of systems: a pay-as-you-go system, which is the form traditionally used in the region, and an individual capitalization, or funded, system.

Under what is known as the *pay-as-you-go* type of system, the incomes of the present working population are tapped in order to pay predetermined benefits to the retired population. Under this kind of system, commonly-held reserve funds may be built up. In that event, and taking into account the "short-sightedness hypothesis", such a system could help boost private savings. Of course, the savings will disappear if they are used to finance other current fiscal expenditures or consumption by other economic agents. This might occur, for example, if, when establishing a system of contributions under a social security retirement plan, the total sum being paid into the system is used to pay retirement benefits to an older (over 65) population which had previously not been entitled to such benefits, or if the reserve funds created with these contributions are used for unprofitable investments.

The *capitalization, or funded*, system involves, first of all, preparing a balance sheet for each participant in which invested contributions will equal discounted benefits. Under this sort of system, the principle of social equity is expressed only in the sense that the system pays out the benefits which are each individual's due according to his invested contributions. The funds taken in each year, based on the contributions of the current EAP, constitute, according to the "short-sightedness hypothesis", net increases in private saving by the system. This system operates apart from the fiscal budget, but the State does regulate and supervise it as it relates to social equity, as well as playing a supportive role by providing fiscal subsidies to supplement the pensions of retirees

which would otherwise fall below a specified minimum sum.

Since the main idea of the pay-as-you-go pension system is —*with the exception of adjustments for demographic changes*— for each generation to pay for the retirement of the preceding generation, the latter usually does not generate savings. This observation is borne out by the experiences of those countries in the region that have put this type of pension system into practice. In contrast, the establishment of a pension system based on the individual capitalization of compulsory contributions will increase net savings since, even if short-sightedness is a factor to some extent, the amount saved under such a system will be greater than voluntary savings would be. This will tend not to be the case, however, if a funded system is substituted for an existing pay-as-you-go system having relatively broad coverage, for although the contributions of new participants in the funded system will boost private saving, the deficit that will be created in the old pay-as-you-go system owing to the failure of the next generation to join that system (the generation that was supposed to have paid for the benefits received by the retired population) will generate an equivalent dissavings in the public sector. The net effect on savings will therefore be nil, barring differences in the demographic structure as regards the incomes of older and younger generations. It follows from the above that, since the vast majority of the countries in the region already have pay-as-you-go pension systems in place, it would probably not be possible to raise savings significantly by replacing them with funded systems.⁸

Nonetheless, it is still possible to raise saving substantially by making improvements in the pay-as-you-go system, since many such systems currently suffer from cash shortfalls, and the elimination of such deficit could substantially increase national saving.⁹ In addition, even systems that do not have a cash shortfall may have an actuarial deficit (this will be explained immediately below) whose

reduction would raise saving, at least during much of this decade.

In fact, deficits often exist in pay-as-you-go systems because these systems not only transfer income from the working population to the retirement-age population, but they frequently do so, in practice, on the basis of predetermined benefits for retirees and contributions proportional to the income levels of those who are paying into the system. Since it was often the case in the past that pre-established benefit levels were quite generous —since initially the system had a cash surplus— the benefits provided tend to be excessive and cannot be fully covered by current contributions when they are being paid out to a much larger retirement-age population. Furthermore, since pensions are usually set on the basis of declared income during the last few years before retirement rather than according to the contributions made during the retiree's working life, there is a tendency for workers to evade a portion of their assessed contributions by under-reporting their income up until the last few years before retirement.¹⁰ None of these shortcomings is an inherent part of pay-as-you-go systems. However, a number of studies conducted by ECLAC demonstrate that this type of problem is quite common and is part of the reason, in conjunction with the use of reserve funds for short-term fiscal expenditures or the failure to maintain such reserves, why many of these systems have ended up with serious cash deficits.¹¹ In point of fact, the oldest and most comprehensive systems in the region (in Argentina, Cuba and Uruguay) have cash shortfalls of between 2% and 6% of GDP.

Even when a pension system does not suffer from this type of cash flow problem, it may have an actuarial deficit in the sense that the existing level of contributions does not take into account foreseeable changes in the ratio between the size of the working and retired populations, as a result of which there is a failure to set up a sufficient reserve fund in order to hedge against an increase in the number of retirees in relation to workers. Indeed, in designing a pay-as-you-go pension system, it is

essential that consideration be given to the financial implications of a gradual ageing of the population, since this may lead to an increase in the number of pensioners relative to workers. This problem is particularly important in the countries of the region, where the population is aging as a result of the combined effect of sharp and quite large decreases in fertility, on the one hand, and progress in reducing mortality rates, on the other.

In point of fact, as mentioned in chapter I, the population projections prepared by CELADE for 1990-2020 in Latin America indicate that life expectancy after retirement will rise while fertility rates will continue to decline, as a result of which the ratio of people of working age to persons over age 65 will fall from the current figure of 12.6 potential workers per retiree to 8.7 in the year 2020. This is a decrease of around 30%, which means that pay-as-you-go pension systems will have to institute 30% increases in contributions between 1990 and 2020—which would raise savings during this period by several points of GDP—or else add to the fiscal deficit, increase taxes or reduce future benefits. In fact, a pay-as-you-go system that projects an increase in the ratio between retirees and workers already has an *actuarial* deficit, even though it may not yet suffer from a cash shortfall, unless it has provided for these changes when setting the level of benefits to be received by retirees and the size of the contributions to be paid by participating workers. If a system anticipates such changes—as a system must if it is to hold the ratio between contributions and benefits relatively steady for each generation and thereby avoid a major lapse in terms of inter-generational equity—contributions have to be raised (or benefits have to be lowered) before the change actually takes place; this course of action would boost national savings in times such as these.

The preceding observations suggest three main ways in which the region's existing pension systems might be reformed. These are: i) the improvement of the pay-as-you-go system by correcting its past shortcomings in order to keep the system on a sound financial footing;

ii) the establishment of a funded system in which the State plays an essential role in guaranteeing minimum pension levels; and iii) the establishment of some type of hybrid system (see chapter IX). As is also indicated by the above considerations, the timing and characteristics of the reforms to be made in pay-as-you-go pension systems and their possible incorporation of some aspects of funded systems will have to be weighed by each country on the basis of its objectives and the demographic and labour-related traits of its population.

Meanwhile, pay-as-you-go systems can be improved by taking steps to strike an actuarial balance between their income and expenditure. Some of the most important recommendations to be made concerning the *financing* of pension systems are as follows:¹²

i) The incorporation of readily intelligible actuarial programming mechanisms that will provide an idea of how much contributions will need to be increased and benefits reduced in order to eliminate any financial imbalances;¹³

ii) The creation of mechanisms for the indexation of the system's financial assets in order to prevent its reserve funds from being eroded by inflation, or the introduction of financial instruments subject to floating interest rates;

iii) A legal prohibition against using reserve funds for purposes other than investments that will benefit the participants in the pension system;

iv) The reduction of delinquency by establishing a system for penalizing workers or companies that are behind in their payments, perhaps by extending the period during which contributions are to be paid; and

v) Upgrading the administration of the system by opening it up to the private sector, mutual funds or both.

b) *Savings and capital formation in the low-income housing sector*

The region's housing shortage is estimated at between 25 and 30 million dwellings, which

amounts to 25%-30% of the 100 million households in the region.¹⁴ Virtually the whole of the affected population is composed of low-income households. In view of the fact that this shortage stems from a lack of financing, it would seem that, in the interests of social equity, the corresponding financial load should be shouldered by the more affluent sectors, that these funds should be collected via the tax system, and that the outcome of all this should be the assignment, through each country's Ministry of Housing, of decent housing to low-income families. Given the scarce supply of public resources, it is essential that they be used with the utmost effectiveness and be supplemented by a savings effort on the part of the beneficiaries themselves.

While it is true that low-income workers' saving capacity is usually quite limited —and that they would certainly save very little if the interest rate were their only incentive—experience has demonstrated that these same workers are capable of making a determined effort to save when doing so will enable them to acquire a decent place to live. Many of these people must devote a sizeable portion of their income (at least 10%) to pay the rent on a dwelling unit that is in such poor condition as to constitute a health hazard. Consequently, the possibility of obtaining a significantly better residence and of owning it themselves can motivate low-income workers to make a great effort to save. Of course, their savings will usually not be enough to finance the whole of the purchase price, whether independently or via normal credit channels. Rather, the idea would be to base the provision of low-cost housing, or access to financing for this purpose, on the greatest possible effort on the part of the beneficiaries themselves. This not only would make it possible to increase saving, but would also reduce the housing shortage in a way which upholds these people's human dignity and independence.

Thus, this approach would involve, on the one hand, providing greater access to sources of financing for low-income housing to people who would otherwise not be able to save enough,

while also promoting the creation of housing cooperatives and the use of leasing arrangements as an interim alternative, and, on the other hand, ensuring that the award of low-cost housing is based, to a significant degree, on the beneficiaries' own efforts to save, whether in the form of money or labour.

i) *Housing credit and savings cooperatives.* Housing credit and savings cooperatives can serve as a channel for the mobilization of funds for middle- and low-income individuals and households in both rural and urban areas who lack ready access to established lending institutions. These organizations may play a particularly significant role in financing housing additions and improvements, but a somewhat less important one in facilitating the purchase or construction of new housing.

For example, the Mexican Confederation of People's Banks is made up of 190 savings and loan associations having more than 200 000 members. The experiences of this organization show that the possibility of obtaining loans swiftly and within a flexible framework is a more important motivation for saving on the part of lower-income groups than interest rates are. Thanks to the personal relationship established with borrowers and to the work done by the committees entrusted with evaluating the applicants, their creditworthiness, the collateral offered and the proposed use of the credit, delinquency is relatively rare.

Furthermore, since until now savings and loan cooperatives in the region have been oriented primarily towards consumer loans rather than towards mortgages and investment, a shift towards housing credit would help curb consumption and boost net saving rates.

However, even in those countries where housing cooperatives have demonstrated their economic viability (by having a large number of members, mounting savings and good credit repayment indexes), the amount of funds channelled through them is small. Uruguay's housing cooperatives constitute a significant exception in this regard; in fact, in the mid-1970s they reached the point where they were

handling nearly 30% of all housing construction funds. Mutual aid cooperatives have offered as much as a 50% cost advantage over private builders, even excluding the manpower provided by the beneficiaries themselves. Cooperatives have managed to build economical, good-quality housing complexes with well-designed common areas and housing services. Moreover, cooperative members have performed better in terms of the repayment of their loans than other debtors, despite their lower incomes.¹⁵

ii) *Private capital for low-cost housing.*

Renting a core housing unit meets the needs of young, lower-income families in particular and is seen as a step towards homeownership. An interim alternative, which may also come to play a significant role in this regard, is the leasing of low-cost housing. Under this type of arrangement, a company buys low-cost housing with a view to renting it out on the basis of a long-term contract which includes a purchase option. Thus, leasing makes it possible for low-cost housing to be occupied and eventually bought by low-income families who would otherwise be unable to do so because they lack access to any of the usual types of mortgage financing. Under such a system, not only can low-income families obtain a better home than they could normally afford, but in order to do so they also make an effort to save that they would not otherwise make.

Thus far, no private capital has been invested in low-cost housing in Latin America and the Caribbean. This is attributable to public policies' bias towards the construction of low-cost housing for final purchase and to the fact that the regulations and standards relating to the renting and sale of such housing have made it unattractive to private investors.

iii) *Saving as a prerequisite for housing subsidy eligibility.* The screening mechanisms used for public low-cost or core housing programmes should require prior savings as evidence of the applicants' desire to help themselves and of their sense of personal responsibility. As an incentive, points could be

awarded on the basis of these accumulated savings, which could serve as a supplementary source of financing. These points would then be one of the factors taken into consideration in awarding public subsidies (see box VII-1).

Since the income levels of many families is very low, they might be given the option of substituting their own labour for a portion of the prior savings. This could be done within the framework of self-help construction programmes, of which there have been many successful examples in the region. Many lower-income households have the ability to work and the initiative needed to undertake self-help housing construction and improvement projects. Of course, in a strong economy in which all members of the labour force have access to productive employment, large-scale self-help construction projects would run counter to the most basic principles of the specialization and division of labour. In developing economies which suffer from high rates of underemployment and of underutilization of the workforce, however, it is important that these otherwise idle resources should be mobilized in a way that will promote a sense of solidarity and a spirit of mutual assistance.

It is also important to focus State assistance programmes in order to reach primarily the lowest-income sectors by limiting programme applicability to housing whose total value is equivalent to or less than a given market price.¹⁶ Under these circumstances, a flat-rate subsidy will have a progressive impact since it will benefit the poorest groups the most.

This housing subsidy could be extended to cover the purchase of housing units, whether new or used, and the improvement of existing units based on the appropriate regulations. Despite the importance of upgrading existing housing, virtually no subsidies are provided for this purpose in the region.

The subsidy could be granted to housing consumers or directly to users in the form of a non-reimbursable sum that could only be applied towards the purchase or construction of housing. The first option would provide the beneficiary

Box VII-1

CHILE'S EXPERIENCE WITH PRIOR SAVINGS REQUIREMENTS
AND DEMAND-SIDE HOUSING SUBSIDIES

In 1986-1990 the number of savings accounts earmarked for the purchase of housing climbed by 100 000 per year. By the end of 1990, the banking system was holding nearly 550 000 such accounts containing the equivalent of over US\$200 million, and savings plans involving nearly US\$500 million were in progress.

Chile's demand-side subsidy consists of a non-reimbursable sum of money which the recipient can put towards the purchase of a new dwelling or, subject to certain restrictions, a used residential unit. The fulfilment of a savings plan is an eligibility requirement for this public subsidy.

This system has permitted the development of a competitive housing market and a private low-cost housing industry which has a great deal of entrepreneurial and professional expertise. The industry operates on the basis of very high levels of productivity and efficiency, and has made a visible improvement in the quality of low-cost housing. At the same time, it has also helped to improve the operations of housing cooperatives designed to serve lower-income sectors.

Under this system, "direct" subsidies which provide the recipients with purchasing power are granted when the market price of the dwellings in question is at least US\$8 000, approximately. In 1988-1990, subsidies were granted for over 30 000 housing units per year, which was more than one-third of all the housing constructed during that period.

For housing units having a lower value (starting at around US\$4 000), "indirect" demand-side subsidies have been used. In these cases the State buys the dwelling and then transfers it over to the families in question. This system has not, however, been accompanied by the same degree of improvement in the quality of the housing as has been observed in the case of direct subsidies.

Source: Sergio Almaraz Alamos (consultant), "Financiamiento de la vivienda para las familias de menores ingresos", Santiago, Chile, ECLAC/UNDP Regional Project on Fiscal Policy, 1991 (unpublished).

with "purchasing power" and allow him to choose between two or more dwellings (see box VII-1). The interest rate on these debts should be in line with commercial lending terms, however, so as to avoid granting subsidies other than the direct public subsidy in question. In addition, repayment deadlines should be strictly enforced to prevent an increasing number of debtors from falling behind in their payments, not because of any real inability to pay, but because they think that debts to the Government simply need not be repaid. Tolerance of a significant degree of delinquency merely invites more of the same, which would prevent the housing programme from being extended to include other needy groups.

It is also necessary to develop savings instruments to finance the provision of basic sanitation services (drinking water and sewerage, at the least) not only for new

housing complexes, but also for a large proportion of poor sectors where these services are either lacking altogether or are of substandard quality. The absence of such services leads to a deterioration in living standards and health conditions which has a very strong impact in terms of a lack of social equity, both now and in an inter-generational sense.

It should be noted that the practice of granting subsidies or making other arrangements to facilitate the acquisition of housing in major cities (capital cities and metropolitan areas) spurs the migration (and concentration) of the poor and homeless to these urban areas. As a result, the unit costs of providing core housing infrastructure and goods and services tend to mount, as does the amount of personal savings—or State subsidies—needed to finance them.

3. Creating a capital market for investment in education and training

Education has traditionally been regarded as a basic need of the population, which justifies its financing by the State. The cost of satisfying this need—especially for higher education, whether it be in the form of a university education, technical training or vocational training—is enormous, however. In view of the amount of resources called for and of the financial constraints affecting the public sector, the rate of return and social equity are both exceedingly important considerations, as are efforts to seek out other sources of financing.

Even though investing in education and training is extremely beneficial for a country and its people, not only from a social perspective but from an economic standpoint as well, there is no capital market for financing this type of investment. Consequently, countries invest very little in their human capital, thereby sacrificing both growth and social equity.

Instead, investment in human capital is financed chiefly by the State or by the individuals concerned (or their families). Present financial constraints being what they are, most of the Governments in the region cannot invest as much in education, especially higher education, as would be economically and socially profitable for the country. Moreover, given the severe liquidity squeeze affecting many families in the region, most households do not have the necessary savings to finance more than a very small part of this investment. Despite the "future" income which can be expected to result from training or education, the market does not provide loans for this type of investment. This, in combination with the financial constraints affecting the Treasury and families in the region, is reflected in a severe shortage of investment in education and training.

The major effort which the region will have to mount in the field of education and training if it is to make real progress towards changing existing production patterns with social equity is discussed in other chapters of this proposal. Our focus here is confined to

exploring the important role which the creation of a capital market for investment in education and training could play in that strategy. The fundamental reason why such a market does not exist is the lack of sufficient collateral for loans for these types of investments. Since the "collateral" is the debtor himself, whose future performance (an essential aspect in the case of skilled manpower) cannot be credibly or efficiently ensured simply by a promise or pledge given prior to the commencement of the training,¹⁷ the fulfilment of the contract cannot be sufficiently assured, and this makes it virtually impossible for a private market to be developed for investment in human capital.

A decision by the Government to make up for this lack by providing educational loans does not resolve the underlying problem. Indeed, owing to the lack of an effective form of security for this type of loan, the State itself is currently unable to recover many of these investments. This is compounded by a problem that is specific to many government loans, which is that many debtors do not feel compelled to pay them back because they do not believe that the State will manage to enforce its claim or call in the collateral. Consequently, government educational loan programmes generally have a high rate of delinquency, which renders them unfit to serve as effective mechanisms for attracting resources for this type of investment, despite the importance of the role they do in fact play. For example, only one-third of the government loans granted in Chile for university studies are being repaid on a regular basis.

Therefore, one of the necessary conditions for the creation of a capital market for investment in education and training is the establishment of effective systems for securing and collecting on such loans. If such systems were in place, the rate of return on these types of investments would make them attractive to the financial system. One practical way of providing reliable, efficient means of securing and collecting on these loans would be to take advantage of the society-wide collection capabilities of the social security system and to entrust it with responsibility for automatic

withholding and repayment mechanisms, in addition to its compulsory savings procedures, for that purpose. If this were done, any bank or financial institution whatsoever could grant an individual a loan to defray the cost of education or training. The loan would be repaid through the addition of a specified sum to the individual's usual social security contributions until such time as the debt had been completely paid off. In order to guard against the possibility that workers would not join the social security system, each loan would have to be co-signed by someone who was already part of the system and whose total contributions to date were sufficient to cover the total value of the loan. The co-signer would have to pay the additional sum if the debtor failed to make the required payments. This would provide a full guarantee, a sure means of collecting on the loan and, except in rare cases, a higher rate of saving.

In effect, what this comes down to is using the worker's obligation to pay into his retirement plan as a form of collateral. Since, under the system of compulsory payments into the pension scheme, the State is in debt to every worker, the above procedure would make use of this circumstance as a means of securing the loan. It would not interfere with the social security system or affect its funds. It would not involve converting the fund's assets into present expenditure. Instead, it would simply be a matter of adding the loan payment to the social security contribution. Thus, except in rare cases, it would *raise the saving rate*. This is because, by making it possible to undertake investments in human capital which, although very profitable, are not currently financeable, the creation of this type of capital market for investment in education and training would not only improve the allocation of investment and increase the opportunities open to the vast majority of the population, but would also raise the net level of savings and investment.

Furthermore, in order to reduce the risk involved in this type of loan even further, a secondary market for such instruments could be created in which an institutional investor which has longer-term liabilities (e.g., an insurance

company) could buy a given number of such loans. This secondary market would not only reduce risk via diversification but would also make such investments more liquid.

A market for investments in human resources would be particularly useful in helping to finance higher education (university and advanced technical schooling), as well as training, since these types of instruction generally cost the Treasury between 5 and 10 times what primary and secondary education cost. In addition, the individual concerned would usually be the one who would receive most of the benefits to be derived from an increase in his educational level, since he would earn a higher income and have better job opportunities, except in the relatively rare cases of professions that have a significant "social externality"¹⁸ (such as pure science, where research is essential). Thus, most higher education would be paid for out of the student's own pocket or with loans, while the State would confine its involvement to financing only the relatively small portion which corresponds to "social externalities".

The same can be said of training for workers throughout their working lives (see the discussion of training in chapter VI). Although an employer may be interested in upgrading an employee's training, his interest usually falls far short of the actual advantage to be derived from that training. In fact, even the most progressive companies are not sufficiently motivated to fill this gap because, strictly speaking, it is in their interest to finance only that type of training which will raise a worker's productivity *in their firm only* (this is what is usually called "specific" training), so that they may recover their investment. If they were to finance a type of training which would raise that worker's productivity in any number of firms, rather than only the one in which he is employed ("general" training), they would have to pay him a wage commensurate with his productivity, and would then fail to recover that investment. Accordingly, training —especially general-purpose training, which is what is normally required by the great majority of workers in small and medium-scale businesses— will have

to be financed by the State or by the workers themselves. In view of the constraints affecting most fiscal budgets, there is a clear need to create a market that will permit workers to accumulate savings which they can then invest in themselves.

4. Funding for investment projects in small and medium-scale enterprise

A strategy for changing the region's production patterns cannot be structured solely on the basis of large-scale enterprises. In order for economic growth to be sound and for its benefits to reach the great majority of the population, the modernization process must be something in which a majority of employers and of the national workforce are involved. This means that small and medium-scale enterprise¹⁹ must take part in this process, since it is this sector where most new firms are first created and organized, where new generations of what will become tomorrow's entrepreneurs are trained and gain experience, where the bulk of the region's value added is produced, and where the vast majority of the labour force is employed. This is the only way to do away with the extreme differences in productivity and technology which separate big business from other firms and to bring the income levels in different sectors and strata closer together. Small and medium-scale enterprise constitutes an important sector in both developing and developed countries, but in the latter it has many links with big business and, although its productivity is lower, there is less of a disparity than in Latin America (between 20% and 50% lower, rather than several times that amount). This has not been achieved without effort, however. A special institutional structure has had to be created to promote small and medium-scale enterprise and to meet this sector's special needs, particularly with respect to financing.

One of the main reasons for the extremely low productivity of small and medium-scale enterprise in the region is that such firms lack access to capital markets and therefore must

finance their expansion and purchases of goods and services on their own. *Consequently, they can expand only as fast as their saving capacity permits, even if their prospects are expanding more rapidly, and therefore must work with extremely outdated technologies at very low levels of productivity.* This lack of access to capital markets and technologies also means, in many cases, that small and medium-scale firms pollute more and do relatively more damage to the local environment than many other firms, which places them among the ranks of those production units that play a significant role in the creation of negative externalities. As stricter environmental guidelines and quality standards are established, the economic performance of small and medium-scale firms may deteriorate even further. Given the large number of such firms and their importance within the production structure and social fabric, their limited access to capital markets could even seriously hamper the very establishment of such environmental standards. In fact, except for the largest companies in each country whose shares are traded on the stock exchange, the only long-term capital to which business enterprises have access is their own; even the distribution of working capital is biased in favour of large-scale firms. For example, as a consequence of the liberalization of Chile's financial market in the mid-1970s, a large part of the country's external debt overhang became concentrated in just two economic groups (the owners of the two leading private banks in the country), which invested most of the money in related companies. The cost to the public sector —i.e., to the Central Bank— of bailing out those two banks, along with the rest of the financial system, and of absorbing their losses during the 1981-1983 recession has been estimated at about US\$9 billion, which is equivalent to nearly 40% of the country's GDP as of 1989.²⁰

It is worth taking a moment to consider some of the factors which limit such companies' access to the capital market. First, adequate mechanisms for securing loans are lacking due to an insufficient supply of the types of assets that could be used as collateral, an absence of

suitable accounting systems for establishing a firm's ability to pay, and shortcomings in the preparation of technical and economic project evaluations. Secondly, small-volume operations are unattractive to financial institutions because their profitability is diminished by administrative, supervisory and other expenses which are incurred regardless of the size of the transaction. Thirdly, in some cases banking regulations do not provide for certain types of transactions, such as leasing arrangements and participation in investment funds, which are especially geared to the financing needs of small businesses.

a) *Leasing as a financing option*

Under this type of arrangement, a firm specializing in leasing acts, as a financial institution in that it acquires a specified capital good at the request of a person interested in leasing the item in question. Because the equipment is owned directly by the firm, the guarantees and collateral required in the case of bank loans can be dispensed with. This makes it possible for small and medium-scale firms to readily secure financing for capital goods that they could normally not obtain except with their own funds.

Leasing is a suitable means of acquiring both new and used equipment. Although the latter modality has not come into widespread use in the region, it constitutes an especially promising possibility for small and medium-scale firms because they often need to buy used equipment, for which conventional loans cannot be obtained. Leaseback arrangements (whereby capital goods are purchased from a company and then leased back to the vendor) are another modality for providing small-scale entrepreneurs with long-term working capital.

Thus, leasing is a specialized system of investment financing which has certain advantages over bank financing, including the possibility of improved risk assessment and the reduction of administrative and transaction costs. The leasing firm, as owner of the capital goods

in question, can limit the risk involved, since it has direct control over its portfolio and can verify that the equipment is being used correctly in the specified investment projects.

Leasing offers two main advantages in terms of changing production patterns with social equity. First, it is by nature strongly oriented towards small and medium-scale enterprise and permits the entry of new agents into production activity. Secondly, to trigger a growth process it is not enough merely to raise the level of saving; the supply of savings must also be efficiently channelled to investment so that it will not be drained off in other directions. Leasing meets this second requirement as well, since it is closely connected with the acquisition of capital goods.

These characteristics are what makes leasing important for the development of the countries of the region. Nonetheless, whereas leasing accounts for a significant percentage of gross fixed capital formation in some developed countries (over 10% in the United States, the United Kingdom and Spain), in Latin America and the Caribbean it generally represents less than 1%. Consequently, there is still a great deal of room for the development of this system in the region.

Chile, which leads the countries of the region in terms of the consolidation and dissemination of leasing arrangements, appears to have hit upon a promising formula for assisting small and medium-scale enterprises in this regard (see box VII-2). Lessors vie with commercial banks in competitive bidding for the proceeds of loans from multinational financial institutions. This enables them to expand their sources of refinancing and thereby reduces the cost of the funds, makes the commercial banks more independent and makes it more likely that the funds will be lent to smaller firms.

b) *Loan security funds and collective loan guarantees*

The difficulties which small and medium-scale entrepreneurs have in providing adequate

Box VII-2

LEASING AND SMALL AND MEDIUM-SCALE ENTERPRISE IN CHILE

In Chile, the leasing sector has been growing steadily since 1986. Rates of increase in contract volumes have ranged from 15% to 25% per year, and by mid-1991 this meant that such contracts represented a total of US\$320 million. The market has matured considerably in recent years as it has broadened the range of items available for lease, its operational modalities and the sectors from which it draws its clientele.

An increasing tendency has been observed on the part of leasing companies to deal more with small and medium-scale firms. In fact, during the first quarter of 1991, 53% of the total number of contracts held by three of the largest leasing companies (accounting for 80% of the market) corresponded to enterprises having sales volumes of less than US\$400 000. In terms of value, these contracts represented 19% of the total (excluding some very large-scale operations). The average contract size for the manufacturing sector as a whole was US\$20 100, while for these operations the size of the contracts ranged from US\$1 200 to US\$6.5 million.

In the case of two major leasing companies, which together have 56% of the market, collateral requirements are steadily being lowered; as a matter of fact, leasing companies now demand very little real collateral (less than 10%) because experience has shown that the leasing companies' possession of legal title to the equipment and the equipment's profitability are enough to hold collection problems to a minimum.

In order to make leasing an even more attractive option for small businessmen, greater opportunities for refinancing will have to be offered. To this end, consideration might be given to the possibility of allowing pension funds and insurance companies to invest in the bonds issued by leasing companies. Recently, these firms have gained direct access to international resource flows (IDB and the World Bank) by entering into direct competitive bidding against commercial banks. In fact, 80% of the funding at stake in the first round of bidding (US\$24.7 million) on the CORFO/IDB third multisectoral project was awarded to leasing companies and approximately half this amount was placed in operations involving less than US\$50 000 each.

Source: O'Higgins Leasing, "Perspectivas del leasing en Chile", Santiago, Chile, 1991 (unpublished); information provided by the Chilean Association of Leasing Companies; and Estrategia, Santiago, Chile (various issues).

collateral limit their access to funds within the financial system. Charging substantially higher interest rates to offset the individual risk is not usually a satisfactory solution because it impairs borrowers' ability to repay the loan or induces lenders to approve the highest-risk credits (a phenomenon known as "adverse screening").

Loan security funds provide small and medium-scale businesses with greater access to investment loans from financial institutions by covering a percentage of the losses sustained by the latter in the event of default. The money to cover these losses and the fund's operating costs usually comes from premiums paid by the users. Thus, by joining such a collective fund, individual borrowers reduce the level of risk involved in lending to them.

Experience indicates that the success of collective loan guarantee funds depends on the following factors: i) the preparation of an adequate credit appraisal by an independent agency; ii) the setting of the percentage of the loan to be covered by the guarantees at between 70% and 80% in order to forestall the approval of overly risky credits; and iii) the establishment of clear-cut, expeditious procedures for collecting on the guarantees (see box VII-3).

A second option is the formation of "borrowers groups" of small businessmen who band together to apply for and to guarantee loans collectively. Since each group member assumes several liability for the whole of the group's debt, the group's screening of potential members and its collective monitoring

Box VII-3

ECUADOR'S NATIONAL RECIPROCAL GUARANTEE SYSTEM

In 1980 the National Reciprocal Guarantee System was created in Ecuador in order to make bank credit more accessible to small businesses in the manufacturing, agricultural, fishery and commercial sectors.

The core units of the system are made up of special boards, trade union groups and savings and loan cooperatives. These units, in turn, form what are known as "credit guaranty corporations" which issue loan guarantee certificates that entrepreneurs can use to apply for bank loans. Members of the core units are automatically members of the corporations as well. The corporations obtain their capital from initial payments and regular contributions from their members, and this capital is then used to form the corporations' loan guarantee funds. In order to cover their expenses, the corporations charge a 4% annual commission on the sum covered by its guarantee; this supplements the income derived from the investment of the guarantee funds.

At the system's centre is a second-tier institution called the Corporación de Retrogarantía (CR), which backs up a portion of the guarantees provided by the credit guaranty corporations. CR obtains its capital from contributions from the Central Bank, the Banco de Fomento (development bank), the corporations, third parties and from financial institutions on a voluntary basis. Its expenses are covered in much the same way as are those of the credit guaranty corporations. Its credit risk is distributed in the following manner: 60%-65% is assumed by CR itself, 20%-25% by the credit guaranty corporations, and 10%-20% by the financial institutions.

The guarantees are given for working-capital and fixed-investment loans having terms of no more than two years. The maximum sum is 2 million sucres. At present, there are eight corporations in operation in seven different regions. The Banco de Fomento, six commercial banks and three other financial institutions serve as intermediaries.

Since the system's units are multi-purpose institutions, they are able to make use of mechanisms for monitoring their borrowers and ensuring that they handle their affairs in a responsible manner. Furthermore, only 10% of the members of these units actually apply for loan guarantees, which facilitates their operation. The credit multiplier has gradually risen from 10 to 15.

Source: Ecuador, Sistema Nacional de Garantía Crediticia and Corporación de Retrogarantía (CR), Sistema Nacional de Garantía Crediticia. Manual jurídico, Quito, 1989, and information provided by the Corporación de Retrogarantía.

of individual performance help to ensure repayment and reduce the risk to financial institutions, thereby permitting small businesses to obtain credits at competitive interest rates. In order to encourage saving and promote individual responsibility, prior savings may be required of each participant and may be held in the form of security deposits or funds until the group loan has been completely repaid. Experiences with this type of modality have shown that when the above conditions are fulfilled, recovery rates higher than those of other types of credits can be achieved.

c) *Technical assistance as a means of promoting lending to small businesses*

A whole range of credit policy measures may be required in order to fully develop small and medium-scale enterprises' growth potential. Such measures may include technical assistance and support in other areas closely related to the production activities of such enterprises.

Small businessmen, whether urban or rural, not only have limited access to financial resources, but also often lack the necessary information to manage their businesses in such a way as to compete successfully under the

prevailing conditions of technological development. Technical assistance in production- and trade-related aspects of their activities can help to strengthen these firms and make them more attractive to lending institutions.

The linkage of loans to technical assistance is an extremely promising tool, not only because of its potential impact on production and commerce, but also for environmental reasons. Particularly in the rural sector (small-scale farmers), such assistance can and should help to augment the environmental sustainability of farming activities as well as, in many cases, leading to significant improvements in their yields and economic viability in the medium and long terms, as well as in the short run.

Agricultural trust funds have been set up in some instances to provide integral support for low-income producers; this support performs many of the same functions that loan security funds do, as well as including lines of credit and technical assistance for small-scale farmers (see box VII-4). In order to encourage banks to participate more actively in the financing of small-scale rural enterprises, such trust funds discount the loans extended to this sector. It should be emphasized that these credits are not subsidized, since they carry interest rates which are adjusted in line with the average percentage cost of bank funds.

d) *Investment instruments*

Small and medium-scale firms' financing needs are not confined to their credit requirements. Investment projects also need long-term capital resources which will allow business initiatives to be undertaken relatively independently of short-term fluctuations in the financial market. Capital investments, risk capital operations and the use of the stock market are all possible means of obtaining long-term capital.

Both equity and risk capital investments consist of the formation of a partnership between an investor and the originator of an idea or project relating to a small or medium-scale

enterprise that is soon to be created or is already in operation. These initiatives generally carry a fairly high risk, since they involve a new entrepreneur, a new product and a technological innovation or a new type of strategy. Accordingly, they also have high growth and profit potentials.

New enterprises based on technological innovations usually lack the collateral they need in order to attract investors. Their lack of a business record and the uncertainty of projections as to the term of the investment also prevent such projects from obtaining financing through traditional channels. Securities markets cannot meet these types of financing needs satisfactorily either because such projects are initially too small or because they lack a sufficient "track record".

The type of financing reflects the interests of both the investor and the project originator. The investor seeks a high rate of return and control over the risk he has assumed by becoming a partner in the enterprise. In this type of partnership, the investor usually holds less than 50% of the equity. The project originator, for his part, attempts to secure financing under terms and conditions suited to the length of the investment and tries to retain part ownership of the results. In order to encourage saving and foster individual responsibility, the originator may be required to finance a certain percentage of the total cost of the project. Both the savings and credit instruments used should, of course, provide an adequate real rate of return.

In the case of risk or venture capital funds, the investor's participation is limited to a specified term, which is completed when it is determined that the project or enterprise has matured enough to be transferred in its entirety to the originator or to a third party. In the case of equity investment funds, on the other hand, investors usually participate on a long-term basis.²¹

The stock exchange is another source of long-term capital. These exchanges have traditionally traded instruments issued by the public sector and by large corporations which fulfil certain conditions in respect of market

Box VII-4

THE BANCO DE MEXICO'S AGRICULTURAL TRUST FUNDS

The three trust funds set up by the Banco de México to serve the agricultural sector are an example of an initiative to provide integral assistance to small-scale farmers which has been successful in terms of continuity, management efficiency and the volume of resources mobilized. The chief objectives of these funds, which were established in 1954, 1965 and 1972, are:

- i) To raise the productivity of small-scale farmers by promoting capital formation and the adoption of modern production methods;
- ii) To promote the production of those staple foods for which the greatest domestic deficit exists, in terms of either production or consumption; to encourage the exportation or import substitution of agricultural products and, more recently, to foster the development of the country's fishery production potential; and
- iii) To induce the banking system to play a greater role in the extension of rural credit, particularly to low-income producers in the agricultural sector.

Through these trust funds, the Banco de México channels financial resources and supports the extension of bank loans to low-income producers by providing partial loan guarantees and subsidizing a portion of the technical assistance provided. In 1988, technical assistance was furnished by 1 757 specialists and gave rise to reimbursements amounting to US\$10.7 million.

In order to be eligible for these credits, the borrowers must put up a specified percentage (5% in the case of low-income farmers; 20% for other producers) of the funds needed to carry out the project in question.

A total of about US\$1.17 billion in bank credit was granted to 972 420 producers under this trust fund discounting programme in 1988; 64% of this sum corresponded to working-capital loans while the remaining 36% was channelled to fixed capital investments. A breakdown by area of activity shows that 63% of the loans went to staple food producers, 13% to agroindustry and 24% to export and other activities.

Source: Banco de México, Fideicomisos Instituidos en Relación con la Agricultura (FIRA), Informe anual 1988 de los fideicomisos instituidos en relación con la agricultura en el Banco de México, Mexico City, 1989, and "¿Qué es el FIRA?", Mexico City, 1988 (pamphlet).

presence, the number of shares offered, and other requirements established by the relevant regulatory and supervisory bodies. As a rule, the stipulated volume of offerings and market presence, as well as other legal requirements, put the exchanges beyond the reach of smaller firms, thereby restricting their investment opportunities and growth potential.

The experiences of more developed countries, however, indicate that, with the help of appropriate modifications in the exchanges' regulatory and supervisory systems, a specialized type of market, known as a "third" or "over-the-counter" market, can be developed. This is another stock market, or an off-the-board section of the stock exchange, which is especially adapted to the characteristics and

needs of small and medium-scale companies. The successful introduction of an over-the-counter market depends, *inter alia*, on the following factors: i) the possibility of adapting the regulations concerning entry and participation in the market to the smaller volume and lower frequency of trading in the stocks of small and medium-scale firms; ii) such firms' willingness to assume corporate status, if necessary, in order to issue stock and offer it on the exchange; and iii) the possibility of boosting the demand for this type of stock, primarily by bringing institutional investors into the market.

Despite over-the-counter markets' great potential as a source of capital for small and medium-scale enterprises, so far such markets have not been formed in Latin America and the

Caribbean. However, the National Stock Exchange Commission of Mexico is currently looking into the possibility of creating an intermediate-sized stock market which would be especially designed to meet the needs of medium-scale firms.

e) *Business credit cards*

Small and medium-sized businesses need working capital as well as long-term capital, and they need to be able to obtain it without undue delay at a reasonable cost. Many commercial banks are now using credit cards as a way of meeting these working capital needs, especially in the case of small businesses. In effect, what they do is to offer a renewable line of credit for the purchase of inputs and intermediate goods. In addition to their ease of use and flexibility, as well as their relatively low cost—since repeated credit evaluations are not required for small loans—these cards make banking services more accessible for such businesses. This, in turn, allows them to establish a relationship based on mutual trust which reduces the risk involved and lowers transaction costs. There also appears to be a tendency for banks to offer financial packages based on the use of these business credit cards which permit businesses to make better use of their demand-deposit balances and to obtain timely credit and business information.

5. Improving the land market

The key factor of production in the agricultural sector is, of course, land. Even though land is a form of capital, it differs from other forms in that it is necessarily a fixed asset. Therefore, its ownership generates *rent*, in the strict economic sense of the word. The value of this rent does not, however, affect the supply of land as a factor of production,²² which is why the ownership of land takes on a special economic significance.

Its importance is even greater in Latin America because, for historical reasons, land

tenure is much more concentrated than in any other region of the world. In point of fact, 75% of rural households in the region either have no land at all or suffer from a severe shortage of this production resource, and must therefore contract out their labour on other people's land in order to survive. A more equitable distribution of farmland would not only help to boost peasant farmers' incomes directly, by redistributing land rents, but would also improve the land indirectly, since it would make it less necessary for peasant farmers to work away from their own land, thus allowing them to increase their reservation wage. In addition, a considerable portion of the rent from the land that is worked but not owned by these farmers would be redistributed, making it possible to raise agricultural wages. This improved distribution would also ease the pressure now being exerted on the land (much of which is agriculturally marginal and environmentally fragile) by the survival strategies of the population of small landowners, whose consequences include general deterioration, erosion, fertility loss, reduced yields and, hence, a decrease in the already extremely low level of household income. This provides some idea of the importance for the region of the role which agrarian reform has played in the past—and which, in many countries, it continues to play even today.

Since it may be assumed that the contents of the debate surrounding this subject are already well known, in this section the discussion will focus on a related problem of great significance. Traditionally, access to land has been obtained in one of four ways: inheritance (the most frequent route), a temporary transfer of rights (sharecropping and renting), the settlement of public lands, and the purchase of land in the market. The market for renewable resources is a virtually unexplored, yet extremely important, subject, since the land market's serious imperfections hinder the majority of rural households from gaining access to land and thereby obstruct its deconcentration.

One of the factors which distort land markets is the confusion surrounding the titles to

a very large percentage of land holdings. As a consequence of legal procedures relating to inheritance, property deeds have not been kept up to date in many land registry offices. The difficulties faced by rural residents in familiarizing themselves with the legal and institutional mechanisms for keeping their property rights current puts them at a great disadvantage *vis-à-vis* outside buyers who are in a better position to undertake the necessary legal and procedural steps. Sufficiently efficient, user-friendly mechanisms have not been created to help members of the rural population, and particularly of the peasant population, to protect and update their land titles. This is an extremely serious matter for ethnic groups, indigenous populations and other rural residents who have occupied and worked government or public land for generations on a *de facto* rather than *de jure* basis. Their lack of title to these lands makes it difficult for them to obtain credit, discourages them from making investments and improvements, and restricts their liquidity.

Secondly, there is a general lack of institutional and financial systems for facilitating the purchase of land by members of the rural population. On the one hand, this is because land ownership is so concentrated that the plots put up for sale are usually much too large for these individuals to work by themselves while, on the other hand, even when land is divided into parcels or when plots of a manageable size for a single household are offered for sale, these households cannot usually afford them. As is the case of most small and medium-scale entrepreneurs, most peasants have to finance virtually the whole of the purchase price by themselves or they simply cannot buy the land. Even in cases where the land has remained in the peasants' possession, unless they can afford to acquire the rights of succession or inheritance, they will not be able to obtain a line of credit that will allow them to purchase the whole of the production unit. Indeed, except in a few countries (e.g., Uruguay), access is not provided to lines of credit for land purchases as a means of helping rural residents to become independent farmers.

Thirdly, existing practices as regards the taxation of agricultural land—based on assessed values that are no more than a fraction of the land's market value—not only seriously reduce tax receipts but also, indirectly, encourage the underutilization of land, since the cost of maintaining vast rural holdings in a state of only marginal productivity is relatively small. Thus, besides preventing the Treasury from receiving its share of actual land rents, undertaxation permits the further concentration of land ownership rather than encouraging its deconcentration.

Changing agricultural production patterns have contributed to the formation of rural land markets and continue to do so. Since access to land is a pivotal element in promoting growth with social equity and in shaping the future of rural populations, methods of improving this market should be sought so that, in conjunction with other initiatives for promoting the settlement, subdivision or consolidation of farming areas, ways can be found to provide the most enterprising and efficient small landholders and landless peasant with access to land.

In order to improve the land market and make it accessible to the peasant population, the three problems mentioned above will have to be tackled. First, a large-scale programme for regularizing land titles is needed. In particular, it is absolutely essential that steps be taken to secure the legal recognition of title to the lands inhabited and settled by indigenous peoples and, in some cases, to regain areas and resources which have been lost. Explicit penalties for the violation of indigenous peoples' rights over their resources should be included in the countries' bodies of law. In addition, clearly defined regulations concerning the assignment of public lands are required.

Secondly, the taxation of agricultural land could be based on its production value, which can best be measured by its market value, especially since it is a fixed asset which, to a large extent, generates rents in the purest sense of the word. Exceptions to this rule, if any, should apply exclusively to small plots. Besides augmenting tax revenues, such a tax would

—since it would, in a sense, be part of the overhead— encourage greater productivity and a deconcentration of land as well as a downsizing of holdings as landowners reduce the size of their parcels in accordance with their actual capabilities for working the land on a productive, profitable basis. A more abundant supply of agricultural properties of a more appropriate size would also help the land market function much more smoothly and would be more conducive to the establishment of new family-run farms.

Thirdly, in order to round out the demand side of the picture, it is essential that the financial system play a role in the land market. Consideration might be given, for example, to the possibility of creating special savings and credit mechanisms for land purchases (see box VII-5). Financing for land acquisition should probably be made contingent upon the prospective buyer having saved a specified amount beforehand. The possibility of obtaining a loan for the purchase of land would surely be a much more effective saving incentive than the interest rate would be. Moreover, it would reduce the risk to be assumed by the financial institution, since the lender and the borrower would be personally acquainted with each other; this would be the case especially with respect to repayment, since it is essential to the success of a scheme of this sort that delinquency be kept to an absolute minimum. Finally, the greater the amount of prior savings, the smaller the long-term loan required for the purchase will be and, hence, the better able the borrower will be to repay the loan.

These improvements in the land market would complement the agricultural expansion and agrarian reform programmes currently under way in the region (Guatemala, Honduras and Nicaragua) as well as those now being considered for implementation in, for example, Brazil, Ecuador and Paraguay. In a geographical area such as Latin America, in which about 200 million hectares have been brought under cultivation in the last 40 years and in which large-scale efforts to push back the agricultural frontier continue to be pursued in the area of the

Orinoco, in the Amazon basin and in other zones, it is of the utmost importance in both social and environmental terms to channel these processes so that preferential options may be offered to rural families willing to settle such areas. It has also been suggested that homesteads and title awards should be limited to plots of an appropriate size for family-run farms or medium-scale enterprises.

In addition, systems for providing technical assistance need to be set up —preferably in association with credit mechanisms— to ensure that land is used in a way which is in keeping with its ecology and which will minimize externalities. To this end, ways should be explored, in close coordination with the tax scheme described above, of adapting the various forms of land use to the land's ecosystemic capacity.

Another sphere of activity that would complement efforts to improve the land market is investment of a type that will enhance the value of natural resources, such as the development of irrigation systems. In point of fact, in the last 40 years systems have been constructed to irrigate somewhat more than 8 million hectares (about 8% of the land under cultivation in the region) at an average cost of between US\$3 500 and US\$10 000 per hectare. Indeed, irrigation works constitute the government's largest agricultural investment in a number of countries containing arid or semi-arid land. This provides us with a concrete example of an area in which changing production patterns and increasing social equity are complementary endeavours (see box VII-6). Irrigation also frequently gives rise to the formation of new production units which help to satisfy the peasant population's demand for land; this is especially true of small-scale works, which in most cases are particularly beneficial for peasant economies. It is encouraging to note that, thanks to the development of some new synthetic materials in recent years, small-scale irrigation projects are becoming increasingly feasible and now offer a great potential for the future.

Box VII-5

THE LAND MARKET AND ACCESS TO LAND

1. Leases with a purchase option

Private real estate intermediaries buy up large tracts of farmland that can be divided into smaller parcels and then sell these plots to small-scale farmers under a lease contract which includes a purchase option upon the expiration of the contract. This arrangement has worked well in countries where the political situation has prompted large landholders to sell their holdings under special terms and conditions. These small-scale farmers and their associations have displayed a highly developed sense of responsibility in fulfilling their obligation to repay their debts, so long as clearly worded provisions have been included regarding the termination of the contract in the case of default by the buyer. A secondary market also exists on which such contracts can be transferred to a new buyer.

2. Revolving fund for land acquisitions

This type of scheme is similar to the first in that it involves the purchase of large tracts of agricultural land, half of whose purchase price is usually paid in cash while the other half is paid off in a period of between two and five years. In this case, however, the land is purchased by a non-governmental development organization. The land is then divided into individual parcels and sold over a term of no more than 12 years at 8% annual interest to buyers who have been duly prepared to undertake this commitment. Delinquency rates are very low due to the social pressure exerted by the other small landowners and to the fact that the number and size of the payments are geared to the buyers' actual capacity to pay. The money thus collected is reinvested in the revolving fund, which is also used to backstop production through the provision of working capital and technical assistance as well as to implement health, housing and educational programmes.

3. Co-debtors

Some development banks have provided credit for land purchases to cooperatives which take charge of the administration of the operation and assume the risk involved. These cooperatives, in turn, extend personal loans to their members. This procedure makes it possible to reduce the banks' costs considerably. A key aspect of this arrangement is that each borrower who belongs to the cooperative is a co-debtor with all the other members; consequently, if one member breaches his loan contract, the rest of the group has immediate access to the delinquent member's parcel, which it can then work, rent or sell.

4. Debt-land swaps

Using funds made available by external sources of financial assistance, some non-governmental organizations purchase external debt on the international financial market at a cost substantially below its face value. The difference is used to set up a fund for the purchase of land, preferably land which is the object of a dispute and whose owners wish to seek a solution in which their rights will be respected. This mechanism has been in operation for several years now and has benefited a comparatively larger number of families than those aided in the past by government-run agrarian reform programmes in some countries of the region.

5. Subsidies for the purchase of land

A number of countries now offer subsidies to help poor rural families to buy land as a means of countering the externalities inherent in the social order and protecting the environment.

Box VII-6

INVESTMENT IN IRRIGATION, EMPLOYMENT AND SOCIAL EQUITY

A comparative analysis of underprivileged population groups and of the agricultural and ecological characteristics of the areas where rural populations are located reveals that the highest indexes of indigence and poverty in Latin America and the Caribbean are found in arid and semi-arid zones. In all, 25% of the region's territory receives scant rainfall and experiences severe droughts, and this land is therefore subject to the severe problems associated with arid or semi-arid climates. Under these conditions, the best way to overcome these natural and socio-economic constraints is by means of the sound management of what little water there is.

The use of irrigation in desert and semi-desert agriculture can make a significant contribution to the development and advancement of rural populations. This has been demonstrated in a number of cases. For example, a study conducted in the São Francisco valley of Northeastern Brazil on the net job creation effect of irrigation found that the use of traditional dry-farming practices for the cultivation of beans, maize and other crops generated only 0.06 permanent jobs per hectare per year, but that this figure increased by a factor of 12 when the same crops were grown once a year using irrigation, by a factor of 21 if tomatoes and onions were cultivated using irrigation, and by a factor of 83 in the case of irrigated crops of table grapes. In other words, the figure of 0.06 jobs/year per hectare rose to 0.7 for the same crops with the addition of irrigation, to 1.25 if tomatoes and onions were produced instead, and to 5 permanent jobs per hectare per year if irrigated grape crops were chosen. In the Massangano project in the São Francisco valley, the cost of creating one permanent agricultural job over the 40-year life of the irrigation project was US\$10 000 for the first set of crops, US\$5 600 in the case of vegetable crops and US\$4 600 if grapes were produced.

These findings highlight the importance of irrigation as an effective means of promoting agricultural modernization and of creating jobs, especially in areas whose agricultural and ecological traits make it possible to grow three fast-growing crops per year or permanent crops, such as grapes, which can be harvested 2.5 times annually; the increase in the land's productivity per hectare, in comparison to unirrigated land, is exceptionally large. In addition to its usefulness as an efficient modernization and job-creation tool, irrigation can also help to deconcentrate the ownership of land and to promote the establishment of independent agricultural producers, if public policy is aimed at achieving these goals.

Source: International Labour Organisation (ILO)/United Nations Development Programme (UNDP)/National Irrigation Programme, Informe final, Proyecta impacto social de la irrigación (BRA/87/005), Brasilia, May 1990.

Notes

¹ ECLAC, *Changing Production Patterns with Social Equity*, op. cit., pp. 49-54.

² Examples include the Nichie Bank of Kyoto, Japan, which serves the credit needs of small businesses, and the Investors in Industry ("3i") group, a public corporation in England which provides seed capital to help start up new activities and to enable new companies to gain a foothold in other markets.

³ The ceaseless flow of messages urging the public to buy superfluous goods and services is gaining a power and seductiveness which is strikingly at odds with the purchasing power of vast sectors of the population. In addition to increasing the instability of patterns of social coexistence, much of which

stems from that disparity, this incitement to consume also thwarts efforts to promote saving.

⁴ This is also being done in the United Kingdom and Japan. See *Changing Production Patterns with Social Equity*, op. cit.

⁵ This bypasses the spurious trade-off between increased saving and a regressive distribution of income. It is often argued that, because higher-income groups display a greater propensity to save, in order to increase saving and, hence, growth, a regressive transfer of income from wage earners to upper-income sectors has to take place through, for example, a drop in real wages. The alternative of raising saving among wage earners, even if by means of such mechanisms as compulsory saving, is clearly

preferable, since rather than transferring income to upper-income groups, it would reduce wage earners' current consumption levels as a means of making them the recipients of the future returns on those savings.

⁶ J. Remenyi, *Where Credit is Due: Income Generating Programmes for the Poor in Developing Countries*, London, Intermediate Technology Publications, 1991.

⁷ It is reasonable to suppose that, owing to a shortage of liquidity and their lower income levels, the discount rate for lower-income workers will be greater than for rentiers and upper-income wage earners. This is why many models go so far as to assume a very low or negligible marginal propensity to save on the part of the great majority of workers.

⁸ There may, of course, be other reasons for adopting a funded system, such as curbing evasion or raising long-term financial saving, which (as a positive externality) would contribute to the deepening of the long-term capital market. The fact remains, however, that if a broad-based pay-as-you-go system is in place, then a changeover to the other type of system will have no first-order effect on savings.

⁹ In the long run, correcting these shortfalls will be beneficial in terms of both growth and social equity, since it will then be possible to boost savings and investment and, hence, productive employment. Moreover, failing to reduce the shortfall by this means implies its reduction by inequitable means instead—whether the inequity is inter-generational (e.g., via greater public borrowing) or takes the form of differences between groups that are served and groups that are not (e.g., inflation-based financing).

¹⁰ Clearly, since, under a funded system, retirement pensions are much more closely related to a worker's contributions throughout his entire working life, evasion is much less of a problem.

¹¹ See A. Uthoff and R. Szalachman, Joint ECLAC/UNDP Regional Project on Finance Policies for Development, *Sistema de pensiones en América Latina: diagnóstico y alternativas de reforma*. Costa Rica, Ecuador, Uruguay, Venezuela, Santiago, Chile, 1991, and chapter IX of this document concerning social security and transfers.

¹² Obviously, social security systems also suffer from other problems, apart from those relating to their financing, which need to be addressed. One of the main such problems which has a bearing on social

equity is the systems' strikingly insufficient coverage of the economically active population (coverage in the region ranges from less than 20% to over 60%), particularly within the urban informal sector and among seasonal and day labourers in agriculture. Another is the inequality of benefits (generally in terms of coverage) received by retirees depending on the institution or mutual fund with which they are insured. See Uthoff and Szalachman, *op. cit.*

¹³ Consideration should also be given to the possibility of maintaining contributions and pensions at their present levels while raising the retirement age, which would increase the inflow from contributions and reduce disbursements in the form of pension payments. Apart from the financial aspects of this possibility, the simple fact that life expectancy has increased (by three years between 1950 and 1990) to the point where it now exceeds the present retirement age suggests that the latter is no longer in keeping with the existing situation, to say nothing about the future. Another possibility would be to provide a partial pension to those retiring at age 65, with full benefits being received only after age 68, or something along those lines.

¹⁴ Inter-American Housing Union (UNIAPRAVI), *El financiamiento habitacional en América Latina*, Lima, 1991.

¹⁵ ECLAC, *Cooperativismo latinoamericano: antecedentes y perspectivas* (LC/G.1458-P), Santiago, Chile, December 1989. United Nations publication, Sales No. S.89.II.G.15, pp. 301-317.

¹⁶ The poorest families' incomes are insufficient to give them access to a dwelling whose initial size and quality could be considered adequate. This, in combination with the shortage of public resources, points to the desirability of designing low-cost core housing units in a way that will facilitate their subsequent expansion and improvement, rather than as a finished product, as well as of providing the infrastructure and facilities required for the provision of public services, recreation and commerce that will help the housing to hold its value over time.

¹⁷ This does not preclude, of course, contracts involving a commitment of future labour—as in the case of athletes and artists—but these are generally the exception, since they are quite inefficient contracts. The fact remains that, except in the public sector, there are virtually no contracts under which money is lent to upgrade an individual's training or education on the basis of a pledge to perform work in the future.

¹⁸ An "externality" exists when an investment benefits others as well as those who actually made the investment. In such cases, an investment project's social rate of return is greater than its private rate of return and, in the absence of any counterbalancing factor, it would therefore represent an underinvestment. The classic example is that of an invention which necessarily benefits all, provided that it can be imitated. In order to avoid the underinvestment produced by the invention, patents are created which grant the inventor a temporary monopoly on the fruits of the invention. Even this is an imperfect solution to the problem of "externalities", however, because many inventions are not patentable (e.g., the just-in-time production method) and even when they are, the patents do not cover all their externalities; for example, the discovery of the transistor was not merely useful in and of itself but also prompted a search for other materials to perform the same function.

¹⁹ In this section, unless otherwise indicated, the term "small and medium-scale enterprises" refers to any firm that is not traded on the stock exchange and does not have access to international or domestic credit other than short-term financing. Thus, although the term does include microenterprises and small enterprises in the informal sector, it mainly refers to the majority of formal-sector firms that do not have ready access to the capital market.

²⁰ Actually, the US\$9 billion which the Central Bank had to absorb included not only the bailout of the financial system, but also the country's debt reschedulings and the losses of the financial institutions that were liquidated. See Nicolás Eyzaguirre and Osvaldo Larrañaga, *Macroeconomía*

de las operaciones cuasifiscales en Chile, Santiago, Chile, Central Bank, 1989 (presented at the Second Regional Seminar on Fiscal Policy, Stabilization and Adjustment, organized by the ECLAC/UNDP Regional Project on Fiscal Policies in Santiago, Chile, in August 1990).

²¹ Brazil is one of the few developing countries which has made significant headway in establishing venture capital funds for the financing of small and medium-scale businesses. BNDES Participações, S.A. (BNDESPAR), a venture capital subsidiary of the National Economic and Social Development Bank of Brazil, is currently the largest source of such financing for the public sector. This institution, which was created in 1982, is oriented towards the promotion of the technological and managerial development of national enterprises and the consolidation of the capital market. It also seeks to foster Brazilian control over businesses, a broader distribution of equity ownership, and various forms of medium- and long-term financial assistance. It is a public institution which provides financing via the issue of shares. Generally speaking, BNDESPAR's equity investments do not exceed 33% of a company's capital stock.

²² Of course not all forms of income derived from agricultural production are rent in the strict sense of the term, but only that portion thereof which is derived from land *per se*, rather than from inputs in the form of irrigation, fertilization or any other investment aimed at raising its productivity.

Chapter VIII

INVESTMENT IN HUMAN RESOURCES

1. Introduction

Although their natural resource endowment is highly beneficial for the progress of societies, the factors which really determine such progress are their human resources and the capacity for linking and mobilizing them. Investment in human resources makes it possible to strengthen both development and equity: it generates favourable conditions to help societies both to deploy their human capital potential and to strengthen their social structure, thereby improving their capacity to link together individual efforts.

A particularly effective means of achieving these objectives is to concentrate human resources policy on tackling the three causes which reproduce economic marginality and social exclusion from one generation to another: fertility rates higher than those desired; inadequate prenatal and postnatal medical and nutritional attention; and inadequate access to education. Thus, many women have a fertility rate higher than they would desire and have more children than they are in a position to bring up with sufficient economic and affective support; many of these women, particularly those from poor households, have little access to suitable medical attention during pregnancy and delivery, giving rise to infant malnutrition and higher rates of mortality among infants and mothers; and their children only have access to low-quality education and their scholastic performance is lower because of the nutritional problems already referred to and the

unsatisfactory cultural environment. Consequently, when these young people enter the labour market they usually find employment only in casual jobs of low productivity, thereby resuming the vicious circle which feeds inequality by consolidating the integration of some and the exclusion of others.

This chapter concerns human resources policy and centres its attention on these three critical points. As all three of them mutually reinforce each other, they call for immediate and simultaneous action. Acting only on a single level would mean largely throwing away the possibilities of achieving substantial improvements. Likewise, it is obvious that the later action is taken, the greater will be the cost and the less will be the benefits and hence also the profitability of these "investments". For example, a child suffering from malnutrition requires much greater educational expenditure in order to recover what suitable nutrition provided in good time would have prevented him from losing, at only a fraction of the cost. Consequently, the measures taken in these three spheres are true investments in the strictest sense of the term: they represent an outlay now which will generate a flow of benefits with time.

2. Population policy

Population policies cover very broad aspects which can influence the growth and distribution of the population and also migratory flows. This chapter, which centres its attention on the

intergenerational transmission of poverty, within the broader concern of reconciling growth with equity, gives specific consideration to the policies affecting fertility trends.

As already noted earlier, between 1950 and 1990 the population of Latin America almost trebled to 450 million inhabitants. This high population growth rate was due initially to the fact that mortality went down sharply, while fertility rates went down more slowly, remaining close to the level of six children per woman of fertile age until the mid-1960s. From that period, however, fertility began to drop at a surprisingly rapid rate, from six children to a little over three in the early 1990s¹ (see table VIII-1), so that population growth began to slacken and dropped to less than 2% per year by the beginning of the 1990s (compared with 2.8% per year between 1950 and 1960).

This decline in fertility, which as already noted gave rise to a reduction in the population growth rate, was due to a number of factors: greater urbanization, which reduces the value of domestic activities for women compared with participation in the labour market; better education, which raises productivity in the market and tends to induce a higher rate of labour participation by women; the greater coverage of the communications media and the transmission of values associated with the idea of a family that is better cared for rather than bigger; and population policies which make couples more sensitive to the idea of responsible parenthood and inform them of modern techniques of family planning. Such sharp drops in fertility, however, suggest that the above-mentioned factors not only act separately but also in a combined manner which, at a given moment, brings about a qualitative change that gives rise to a cumulative transformation of society. This phenomenon is considered to be due, *inter alia*, to greater knowledge and cultural changes, either spontaneous or due to outside influences, which bring about the reversal of previous trends in the reproductive behaviour of the population.

At the same time, this overall decline in fertility rates conceals substantial differences between countries and between different social groups within the same country. Thus, the demographic transition is only just starting in some countries, so that in many cases the overall fertility rate is still high. It still amounts to over 4.5 children per woman, for example, in Bolivia, El Salvador, Guatemala, Haiti, Honduras, Nicaragua and Paraguay. Equally or even more important is the fact that the reduction in fertility rates has not spread in a uniform manner to all social groups. On the contrary, the evidence indicates that fertility is much higher in rural areas and among lower income groups (see table VIII-2). For example, mothers without any schooling or with only incomplete primary education had fertility rates well above the average (of the order of six children) in Brazil (1986) and Mexico (1987), compared with average fertility rates of 3.5 and 3.8, respectively. More detailed studies carried out in Costa Rica and Guatemala corroborate this appraisal: indigent and poor families have an overall fertility rate almost 60% higher than that of non-poor families.

Nor is it a fact that the poorer groups do not want to reduce their level of fertility. In fact (see table VIII-2),² the level of fertility desired by families in the low economic and social strata, without schooling or with only incomplete primary education (and, presumably, with lower income), is far below their effective fertility, being almost 40% lower in the cases of Bolivia, Brazil and Peru. Likewise, table VIII-2 suggests that generally speaking the poorer the economic and social level, the greater is the proportion by which the effective fertility exceeds the desired level. These facts consequently underline the need for family planning and responsible parenthood policies to reach these underprivileged social groups. These policies, as well as fulfilling important requirements for society as a whole, would thereby be meeting a need strongly felt by couples and, in particular, women.

One of the positive consequences of the decline in fertility in previous decades is that the

Table VIII-1
LATIN AMERICA AND THE CARIBBEAN: GLOBAL FERTILITY RATE*
1950-2000

Countries	1950-1955	1960-1965	1970-1975	1980-1985	1990-1995	1995-2000
LATIN AMERICA	5.91	5.99	5.03	3.94	3.25	3.00
Argentina	3.15	3.09	3.15	3.15	2.79	2.65
Bolivia	6.75	6.63	6.50	5.50	4.56	4.20
Brazil	6.15	6.15	4.70	3.81	3.16	2.91
Colombia	6.76	6.76	4.67	3.51	2.92	2.75
Costa Rica	6.72	6.95	4.34	3.50	3.02	2.81
Cuba	4.10	4.67	3.55	1.85	1.87	1.95
Chile	5.10	5.28	3.63	2.80	2.66	2.60
Ecuador	6.90	6.90	6.05	4.80	3.87	3.50
El Salvador	6.46	6.85	6.10	5.21	4.51	4.16
Guatemala	7.09	6.85	6.45	6.12	5.36	4.90
Haiti	6.30	6.30	5.76	5.17	4.79	4.60
Honduras	7.05	7.36	7.38	6.16	4.94	4.34
Mexico	6.75	6.75	6.37	4.29	3.16	2.80
Nicaragua	7.33	7.33	6.71	5.94	5.01	4.50
Panama	5.68	5.92	4.94	3.46	2.87	2.65
Paraguay	6.80	6.80	5.65	4.82	4.34	4.10
Peru	6.85	6.85	6.00	4.65	3.57	3.20
Dominican Republic	7.40	7.32	5.63	4.21	3.34	3.00
Uruguay	2.73	2.90	3.00	2.57	2.33	2.25
Venezuela	6.46	6.46	4.97	4.10	3.47	3.20
CARIBBEAN	5.22	5.47	4.38	3.19	2.85	2.77
Barbados	4.67	4.26	2.74	1.92	1.79	1.79
Guadaloupe	5.61	5.61	4.49	2.55	2.35	2.24
Guyana	6.68	6.15	4.90	3.26	2.40	2.19
Jamaica	4.22	5.64	5.00	3.55	2.38	2.10
Martinique	5.71	5.45	4.08	2.14	2.08	2.08
Puerto Rico	5.02	4.37	2.99	2.46	2.10	2.10
Suriname	6.56	6.56	5.29	3.39	2.56	2.26
Trinidad and Tobago	5.30	5.00	3.45	3.10	2.70	2.50

Source: United Nations, World Population Prospects 1990, Population Studies series, No. 167, Department of International Economic and Social Affairs, New York, 1991; and Latin American Demographic Centre (CELADE), "Latin America: population projections, 1950-2025", Demographic Bulletin, Year 23, No. 45, Santiago, Chile, January 1990.

* Average number of children per woman at end of fertile period.

Table VIII-2
LATIN AMERICA (SELECTED COUNTRIES): GLOBAL FERTILITY RATE AND PERCENTAGES OF UNDESIRABLE
FERTILITY, BY AREA OF RESIDENCE AND LEVEL OF EDUCATION

	Bolivia 1989	Brazil 1986	Colombia 1986	Ecuador 1987	El Salvador 1985	Guatemala 1987	Mexico 1987 ^a	Peru 1986	Dominican Republic 1986
Total	5.00	3.53	3.34	4.33	4.22	5.60	3.80	4.12	3.80
Desired	3.20	2.83	2.81	3.59	3.08	4.90	-	2.64	2.80
Undesired	1.80	0.70	0.53	0.74	1.14	0.70	-	1.48	1.00
Total	36.0	19.8	15.9	17.1	27.0	12.5	58.9	35.9	26.3
<i>By level of education^d</i>									
i) Low	37.7 (2.4)	38.5 (2.5)	19.7 (1.1)	16.0 (1.0)	25.7 (1.5)	11.4 (0.8)	62.4 (*)	40.7 (2.3)	30.4 (1.6)
ii) Medium/low	38.3 (2.3)	27.1 (1.4)	17.1 (0.7)	19.0 (0.9)	32.3 (1.7)	12.5 (0.7)	64.6 (*)	22.5 (0.7)	27.3 (1.2)
iii) Medium	31.1 (1.5)	13.6 (0.4)	8.5 (0.2)	10.4 (0.3)	22.5 (0.8)	17.9 (0.7)	59.6 (*)	24.6 (0.5)	13.8 (0.4)
iv) High	24.1 (0.7)	11.6 (0.3)	9.5 (0.1)	3.5 (0.1)	21.3 (0.5)	7.4 (0.2)	49.0 (*)	-	9.1 (0.2)
<i>By area of residence</i>									
Urban	35.0	16.1	12.3	16.2	-	14.6	63.3	-	21.9
Metropolitan area					26.9		58.5	26.2	
Other urban areas					30.6		60.3	30.8	
Rural	35.9	27.5	20.7	17.6	25.0	10.8	54.3	42.3	31.3

Source: Programa de Encuestas Demográficas y de Salud. Informes Nacionales. Bolivia: Instituto Nacional de Estadística (INE), *Encuesta Nacional de Demografía y Salud 1989*, Ministry of Planning and Coordination, La Paz, January 1990; Brazil: Sociedade Civil Bem-estar Familiar no Brasil (BEMFAM) and Instituto for Resource Development (IRD), *Pesquisa Nacional sobre Saúde Materno-Infantil e Planejamento Familiar (PNMIPF) - Brasil, 1986*, Rio de Janeiro, December 1987; Colombia: Corporación Centro Regional de Población (CCRP), Ministerio de Salud Pública de Colombia (MS) and Institute for Resource Development (IRD), *Colombia, Tercera Encuesta Nacional de Prevalencia del Uso de Anticonceptivos y Primera de Demografía y Salud 1986*, Bogotá, 1988; Ecuador: Centre for Studies on Population and Responsible Parenthood (CEPAR), Instituto Nacional de Investigaciones Nutricionales y Médico-Sociales (ININMS) and Institute for Resource Development (IRD), *Ecuador, Encuesta Demográfica y de Salud Familiar 1987*, Quito, April 1988; El Salvador: Asociación Demográfica Salvadoreña (ADS), *El Salvador, Encuesta Nacional de Salud Familiar FESAL-85*, San Salvador, September 1987; Guatemala: Institute of Nutrition for Central America and Panama (INCAP), *Guatemala, Encuesta Nacional de Salud Materno Infantil 1987*, Ministerio de Salud Pública y Asistencia Social, Guatemala City, May 1989; Mexico: Dirección General de Planificación Familiar (DGPF), *Guatemala, Encuesta Nacional sobre Fecundidad y Salud 1987*, Mexico City, July 1989; Peru: Instituto Nacional de Estadística (INE), *Encuesta Demográfica y de Salud Familiar (ENDEF)*, Informe General, Lima, April 1988; Dominican Republic: National Population and Family Council (CONAPOFA), *Encuesta Demográfica y de Salud DHS-86*, Santo Domingo, December 1987.

^a In Mexico, no questions were asked in order to estimate the desired fertility. In this case, the figures given in the table represent the proportion of married or cohabiting women who do not want any more children in the future. Consequently, the figures are not comparable with those for the other countries. The categories used for the variable "area of residence" were: metropolitan area, and areas with 20 000 or more, 2 500 to 19 999 and less than 2 500 inhabitants.

^b The global fertility rate was calculated for a period of three years before the survey. The desired and undesired fertility was calculated for the same period, taking into account whether the children were wanted or were result of an unwanted pregnancy.

^c This proportion represents the percentage weight of undesired fertility compared with total fertility.

^d The level of education is grouped from low to high, but the categories vary from one country to another. In the case of Ecuador, Colombia, Bolivia and the Dominican Republic, the categories used were: i) No education; ii) Primary schooling; iii) Secondary education; and iv) Higher or university studies. In the case of Peru, the first two groups are combined in a single category. In Brazil, Mexico and Guatemala, the groups are: i) No education; ii) Incomplete primary schooling; iii) Complete primary schooling; and iv) Secondary or higher education. In Bolivia the groups are: i) No education; ii) Basic education; iii) Intermediate education; and iv) Secondary or higher education. In El Salvador, the groups are: i) No education; ii) Basic, grades 1-3; iii) Basic, grades 4-9; and iv) Secondary or higher education.

(*) Figures not comparable.

number of school children in the region will increase by less than 10% in the 1990s. As public income will increase more or less in line with the growth in the product (possibly by 50% by the end of the decade, if GDP grows at the rate of 4.1% per year), this means that the difference between resources and needs will be available in order to channel more resources to improving the quality of education and mother and child care. This is a global average figure, of course, since the actual availability of fiscal resources for these purposes will vary from one country to another as a function of the decline in fertility. Likewise, and especially where the decline in fertility began earlier, the growth rate of the population of working age will go down to 2.3% per year in this decade, compared with 2.7% per year in the period 1950-1990 (see table VIII-3). Thanks to this decline, the investments required in order to generate sufficient productive employment for those entering the labour force in the 1990s will go down by an average of approximately 1.5% of GDP in the region,³ or alternatively, with the same investment coefficients as before (i.e., around 20% of GDP), the productivity and income of the labour force will grow 0.3% per year faster than they would otherwise have done. These are some of the benefits of the reduction in both fertility and in the difference between desired and effective fertility in the past. Likewise, such benefits can continue to be attained in the coming decades if the countries continue to apply policies aimed at eliminating that difference, especially among the lowest income groups and among women of low educational level, who have not yet been reached by family planning programmes. This latter objective is particularly important for a policy of changing production patterns *with equity*, both because it tackles the lack of equity in access to services (that is to say, it defends the exercise of a right) and because it helps to weaken the mechanism of the intergenerational transmission of poverty.

Such policies must also include other groups which have been relatively neglected so far, however, such as adolescents, among whom

there is a substantial concentration of unmarried mothers who become pregnant and have unwanted children with greater frequency (see box VIII-1). In point of fact, in most of the countries of the region adolescents register relatively high rates of fertility of over 80 births per thousand (not including abortions, which are more frequent among young unmarried women). Clearly, this social problem will call for family planning policies which stress that responsible motherhood and fatherhood involve a lasting economic and affective commitment, which normally requires a stable relationship between the couple.

While it is true that the population policies tried out in the region display considerable variety both in their different approaches and in the way they take account of cultural traditions (see box VIII-2), there is also a wide range of approaches which have proved successful in promoting responsible parenthood and reducing the gap between the desired and effective fertility of couples (see figure VIII-1). There is thus a rich store of experience which can help each country to design the policy best adapted to its own needs and values.⁴

3. Mother and child health programmes

Once conceived, every child has the right to equality of opportunity for his development as a person, or if this ideal situation cannot be fulfilled, at least he deserves a minimum of opportunities, for many of the inequalities in the positions occupied by adults in the most significant dimensions of social stratification are projections of differential situations which affected them as children from their conception to their entry into primary school.

It is hard to exaggerate the importance of the living conditions of the earliest years for the subsequent development of the biological and mental potential of persons, their possibilities with regard to physical and intellectual performance, and the corresponding capacity to take advantage of opportunities for access to social goods. Mothers with problems of

Table VIII-3

LATIN AMERICA AND THE CARIBBEAN: POPULATION GROWTH RATES, BY AGE GROUPS, 1950-2000

	1950-1960		1960-1970		1970-1980		1980-1990		1990-2000	
	15-	15+	15-	15+	15-	15+	15-	15+	15-	15+
LATIN AMERICA	3.3	2.4	2.7	2.7	1.7	2.9	1.3	2.7	0.9	2.4
Argentina	1.9	1.8	1.0	1.7	1.9	1.5	1.3	1.4	0.2	1.5
Bolivia	2.3	2.0	2.3	2.3	2.6	2.5	2.1	2.8	1.5	2.9
Brazil	3.4	2.8	2.5	3.0	1.2	3.1	1.5	2.5	0.7	2.3
Colombia	3.7	2.2	2.8	3.0	1.1	3.2	0.8	2.8	0.7	2.3
Costa Rica	4.5	2.9	3.1	3.6	1.1	4.0	2.1	3.2	0.9	2.7
Cuba	1.3	2.0	2.7	1.6	-0.3	2.1	-2.4	2.2	1.1	0.7
Chile	3.0	1.8	2.1	2.3	0.0	2.5	0.8	2.1	1.1	1.7
Ecuador	3.5	2.4	3.3	3.1	2.5	3.3	1.7	3.3	1.3	2.9
El Salvador	3.4	2.3	3.6	3.1	2.2	2.4	1.1	1.8	1.8	3.0
Guatemala	3.3	2.5	2.8	2.8	2.8	2.8	2.8	2.9	2.3	3.3
Haiti	2.2	1.1	2.1	1.5	1.6	1.7	1.8	2.0	2.0	2.1
Honduras	3.3	3.1	3.5	2.7	3.4	3.3	2.8	3.9	2.1	3.5
Mexico	3.5	2.4	3.5	3.0	2.4	3.3	0.8	3.4	0.8	2.6
Nicaragua	3.8	2.4	3.3	3.1	2.8	3.2	3.0	3.6	2.4	3.6
Panama	3.3	2.3	3.1	2.8	1.9	3.4	0.7	3.0	0.7	2.3
Paraguay	3.8	1.9	2.6	3.1	1.9	3.7	2.7	3.4	2.0	2.9
Peru	3.0	2.3	3.0	2.7	2.2	3.1	1.2	2.9	0.9	2.6
Dominican Rep.	3.6	2.8	3.3	3.0	1.4	3.5	1.2	3.0	0.7	2.5
Uruguay	1.3	1.3	1.0	1.0	0.0	0.5	0.2	0.8	-0.2	0.8
Venezuela	4.6	3.6	3.4	3.5	2.4	4.3	2.0	3.2	1.2	2.8
CARIBBEAN										
Barbados	2.3	0.1	0.0	0.5	-1.8	1.5	-1.7	1.0	-0.6	0.7
Guadaloupe	3.5	2.1	1.4	1.5	-2.8	2.1	-1.1	1.1	0.8	0.6
Guyana	4.6	1.6	2.0	2.4	-0.8	1.9	-1.5	1.7	-0.2	1.7
Jamaica	2.9	0.6	2.5	0.4	-0.2	2.5	-0.5	2.5	-0.4	1.7
Martinique	3.6	1.6	1.2	1.6	-3.7	2.0	-1.2	1.1	1.1	0.5
Puerto Rico	0.5	0.7	0.0	2.4	0.1	2.5	-1.1	1.6	0.4	1.1
Suriname	4.7	1.6	2.7	2.3	-2.5	1.0	0.2	2.8	0.7	2.0
Trinidad and Tobago	3.5	2.4	1.2	1.6	-1.0	2.3	1.6	1.7	0.4	2.0

Source: United Nations, World Population Prospects 1990, Population Studies series, No. 167, Department of International Economic and Social Affairs, New York, 1991; and Latin American Demographic Centre (CELADE), "Latin America: population projections, 1950-2025", Demographic Bulletin, Year 23, No. 45, Santiago, Chile, January 1990.

Note: 15- = under 15 years of age.
15+ = 15 or more years of age.

Box VIII-1

ADOLESCENT PREGNANCY

The Declaration of Oaxaca (Mexico, 10 November 1989), prepared at the end of the International Conference on Adolescent Fertility in Latin America and the Caribbean, notes that the estimated number of adolescents in the region who have had at least one child before reaching the age of 20 currently amounts to 22.5 million.

Although many adolescent pregnancies take place within wedlock, precocious sexual activity and the birth of children to very young couples currently represent a serious social problem because of the consequences they have for the health of mothers and children and their interruption of the parents' projects for the future, which limit the future development of both children and parents. Specifically, adolescent pregnancy, whether within or without wedlock, has the following adverse consequences:

- i) The children of adolescent mothers have a greater probability of being premature, of low weight, and therefore exposed to greater risk of mortality.
- ii) Many adolescent pregnancies, especially those outside wedlock, are unwanted and therefore have a greater probability of ending in abortions.
- iii) Early pregnancy tends to interrupt the educational process and other educational opportunities of young women. Many adolescents who are pregnant or already have children do not complete their schooling, and this restricts their employment possibilities.
- iv) The children of adolescent couples have less possibility of receiving proper health attention than those of older couples, since very young people often lack the economic means to defray these expenses.

One indicator of the magnitude of this problem of adolescent pregnancy is the fertility rate of women between 15 and 19 years of age: in Latin America, this attains values of close to 80 births per thousand adolescents per year on average, and in El Salvador, Guatemala, Honduras and Nicaragua the figure exceeds 130 births per thousand.

Adolescent pregnancy can be avoided, and there are acceptable methods for governments which have been tried out with positive results in a number of countries of the region. The Government of Mexico, for example, has developed educational programmes to prepare young people for family life, including the topics of human reproduction, family planning and sex education, and these subjects are taught in both the primary and secondary schools. In the rest of the region, Brazil, Peru, the Dominican Republic and the English-speaking Caribbean countries have similar programmes, which are supported by international agencies such as the United Nations Population Fund (UNFPA).

Source: CELADE, on the basis of official information.

malnutrition, children of low birth weight, excessively short periods of breast feeding, insufficient ingestion of proteins, calories, iron and vitamin A, exposure to unhealthy environments, deficient sensorial and intellectual stimulation, disorganization of the family, instability of the parent figures, and shortcomings in preschool training are some of the factors which limit the development of the physical and mental potential of children and hence their future possibilities of competing for

access to the most desirable goods and positions in society.

Since the degree of equality of opportunity in the early years of life is one of the most important dimensions for evaluating progress or setbacks in equity, the world of childhood is a particularly appropriate area for judging the greater or lesser equity of societies at a given point in time.

Infant mortality has gone down sharply since the end of the war, and this progress

Box VIII-2

POPULATION POLICIES: VARIOUS ROADS TOWARDS THE
LOWERING OF FERTILITY IN LATIN AMERICA

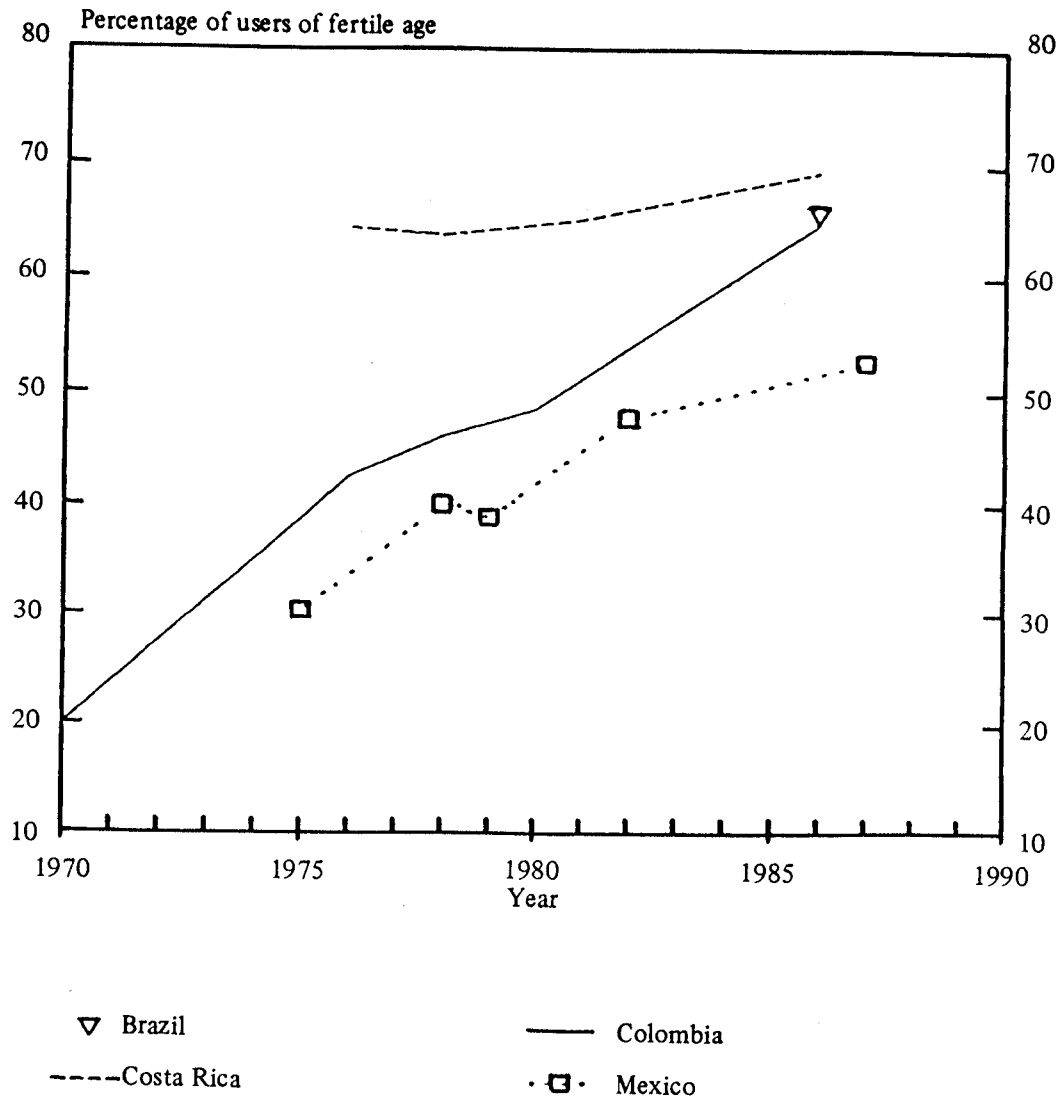
The countries of Latin America which register the most impressive achievements with regard to the extension of fertility control have used a variety of strategies and instruments. Both Brazil and Mexico now have fertility rates which are only about half what they were 20 or 30 years ago. Mexico enacted a General Population Law in 1973, set up a National Population Council (CONAPO) shortly afterwards, and has been formulating and applying national population programmes since 1976. In Brazil, in contrast, however, the decline in fertility has taken place in the absence of a government family planning programme; the voluntary and commercial private sectors, notably the Civil Society for Brazilian Family Welfare (BENFAM), have played a decisive role in this process by providing services, especially to women of the lowest income groups. In both countries, sterilization and the pill are the methods most commonly used, but whereas in Mexico the provision of services and information on family planning is channelled more through the national health service, in Brazil more use is made of publicity in the mass media. Recently, the information campaigns on AIDS in Mexico (and also in other countries) have led to wider knowledge of the condom not only as a method for avoiding AIDS but also as a means of family planning.

Something similar to the case of Brazil also takes place in Colombia, where family planning activities began in 1966 with the creation of private institutions such as the Colombian Association for Family Welfare (PROFAMILIA), which were gradually incorporated into the activities of the national public health service without any explicit population objectives or policies having been adopted. This country, however, displays one of the most noteworthy changes in the extension of contraceptive practices over the last two decades. The success achieved in Colombia is explained by the early expansion of the coverage of services to rural areas and less educated women in urban areas through the "community distribution" system which seeks both to satisfy the existing demand and generate more demand through information, education and communication activities. Contraceptive practices are also now widespread in Costa Rica, which set up a National Family Planning Programme in 1968 and a National Population Policy Council in 1978. Although the latter body has not specifically adopted a policy to change the population growth rate, it has given rise to suitable conditions for its decline. The wide availability and geographical coverage of the services provided for in the National Family Planning and Sex Education Programme is typical of the case of Costa Rica: the success of its programme is attributed to the continued improvement of its distribution system at the level of the community and the use of auxiliary personnel, such as midwives, to reduce the need for the participation of doctors in the provision of contraceptive services. This country differs from Colombia and many of the other countries of the region in that it has achieved predominant use of the pill and other reversible methods rather than sterilization, as a result of changes in the law which makes necessary medical justification —and not only the desire to avoid conception— in order to undergo the latter operation.

A widely shared view on the impact of family planning programmes is that they have had the effect of facilitating the decline in fertility rather than initiating this process, but even though their direct effect may be considered as modest, their indirect effects —through the dissemination of information and the legitimation of the use of contraceptives— have been significant. Although there is still room for improving the effectiveness of the methods currently in use, in most of the countries of the region this effectiveness is relatively high, so that it is considered that the most promising strategies for the future will be those designed to increase the coverage of the programmes, gradually attracting couples who are currently not using any contraceptive method at all.

Source: CELADE, on the basis of official information.

Figure VIII-1
EVOLUTION OF CONTRACEPTIVE USE*
IN BRAZIL, COLOMBIA, COSTA RICA AND MEXICO



Source: M.B. Weinberger, *Changes in the Mix of Contraceptive Methods during Fertility Decline: Latin America and the Caribbean*, document presented at the Seminar on the Fertility Transition in Latin America, Buenos Aires, April 1990.

*Includes the pill, sterilization, IUDs, condoms, etc. Source: Weinberger, 1990, table A.

continued even in the 1980s. Except in a few countries, however, these mortality rates are still several times higher than those of the developed countries. From the point of view of the achievement of more equitable conditions of well-being, this is undoubtedly a very significant fact, since infant mortality is concentrated in the poorest strata and its reduction therefore mainly tends to improve the life expectation of the poor. This is why, although there are still big differences in infant mortality rates between the various regions and between the various social strata within a particular country, these gaps have been narrowing in recent decades.

Some advances in health have undoubtedly had a very marked effect in dealing with this problem. Technological innovations which are now widespread in the world, such as the oral rehydration therapy which makes it possible to counteract the effects of infant diarrhea—one of the main causes of death in that period of life—have reduced the cost of the infrastructure needed to tackle the problem effectively and efficiently, thereby making possible rapid advances in this field. Another similar factor is the transmission of information on the benefits to both mother and children of properly spaced births, for which public and private organizations which already existed in the countries have been mobilized. These organizations were also used to set up flexible and efficient systems of mass immunization against the illnesses which are most dangerous in the early years of life.

Other phenomena which have an indirect but nevertheless important effect also contributed to the decline in infant mortality. Urbanization, for example, facilitated the contact of many mothers with health centres and immunization programmes, gave them more possibility of access to drinking water and sewerage facilities, and also gave them more exposure to messages on child nutrition, hygiene, pregnancy control, etc. Their receptivity with regard to these messages and to the adoption of the corresponding practices were favoured by the parallel rise in levels of female education.

An important feature of the factors which have led to the reduction in infant mortality is that all of them are relatively independent of the vicissitudes of the economy, so that it may be expected that, unless there is a spectacular deterioration in the economic situation and in the level of inequality of distribution of goods and services, the positive trends observed today may well be maintained. There is still much to be done in this field, but the means are now available for considerably reducing infant mortality at relatively low cost, as shown by the experience of such countries of the region as Chile, Costa Rica, Cuba and various English-speaking Caribbean countries.

Equally important, however, are the relatively high indices of mortality among women giving birth and the number of problem pregnancies, the relatively high percentages of newly born babies of very low weight, and the problems of malnutrition during the earliest years. Quite apart from the immediate damage and suffering they cause, all these combine together to seriously impair the subsequent capacity of the child to take advantage of formal education.

In point of fact, one of the most notable differences between the developed and developing countries is the disparity between the rates of mortality among women giving birth. Although substantial progress has been made in this area too (partly thanks to the better spacing of births as a result of family planning), the risk of dying during pregnancy, childbirth or the period immediately thereafter is between 50 and 100 times greater in the developing countries. An extreme case is Bolivia, which has a rate of maternal mortality 120 times greater than that of Canada (to say nothing of the problem of under-registration, which would further increase the disparity). Even more striking—at least in quantitative terms—is the incidence of disabling morbidity due to lack of proper attention during pregnancy, childbirth and the period thereafter. For every woman who dies during childbirth in Latin America, between 12 and 15 remain disabled in various ways. The tragic thing is that the vast majority of these cases of death and

disablement are currently avoidable without the use of sophisticated technologies or very high outlays. For this reason, it is often asserted that in the world of today the death of a pregnant woman (other than for accidental reasons) is as much of an anachronism as freezing to death.

There are two reasons for this situation, which affects above all poor women of the less developed countries. One reason is that approximately half the pregnant women of the lower economic and social strata suffer from iron deficiency anemia as a result of malnutrition, due not only to poverty but also to the general discrimination they suffer because of their sex, which means that they have indices of malnutrition considerably higher than those observed in men. The other reason is the insufficient availability of medical services for timely treatment. In fact, it is estimated that 130 million people in the region do not enjoy even minimally acceptable access to health services, and of this number 90 million are women of child-bearing age or children.

At the same time, malnutrition is undoubtedly the main problem affecting children under five years of age in the region: one out of every six children between one and five years of age suffers from malnutrition, which means that there are almost 10 million children in this situation (see table VIII-4). Indeed, in some countries this percentage exceeds one-third of the total. All the available data indicate that infant malnutrition is of a chronic nature, frequently beginning with malnutrition in the mothers' womb before birth, which causes between 6% and 17% of children to be of abnormally low weight at birth, subsequently aggravated by under-nutrition due to the economic situation of the family.

Once again, sex represents an important difference in the incidence of infant malnutrition, since this affects females to a disproportionate extent and is the main factor behind the excessively high mortality of girls

between one and four years of age. Studies carried out in Brazil, for example, show that the intra-family distribution of food favours primarily adult males and, after them, male children, with girls and women being the last to be served. This same cultural pattern is probably characteristic of poor families in the rest of the region too.

The foregoing suggests that it is necessary to give priority to two main lines of action focussed on: i) the health of the mother, with emphasis on proper institutionalized medical checks and attention (with nutritional supplements, if necessary) during pregnancy and childbirth in order to prevent maternal mortality and disabling morbidity of both mothers and their children; and ii) the health of the children, especially through supervision and maintenance of the processes of growth and development, including initial breast feeding, nutrition and such attention as is required by the epidemiological profile of the countries of the region. These approaches must give priority to preventive action aimed at tackling environmental conditions which cause high levels of morbidity, such as shortcomings in waste removal, the collection and treatment of excreta, and drinking water supply.

The population at which these programmes are aimed includes, by definition, the groups of high vulnerability and risk. Increasing the resources assigned for these purposes would be justified both by reasons of equity and of efficiency. On the one hand, quite apart from the value that may be assigned to human life, the provision of equal possibilities for development, or at least a reasonable minimum of such possibilities, is a generally shared objective on which social cohesion is based. On the other hand, such action designed to take at least a minimum of advantage of the available human talent is a form of investment in people which is essential for promoting strong and sustained growth.

Table VIII-4

LATIN AMERICA AND THE CARIBBEAN: GLOBAL AND CHRONIC MALNUTRITION
AMONG CHILDREN OF PRESCHOOL AGE^a

Country	Year	Global malnutrition (%)	Chronic malnutrition
Barbados	1981	8.8	3.6
Bolivia	1987	18.1	42.2 ^b
Colombia	1986	11.9	22.6
Costa Rica	1987	2.7	6.4 ^c
Chile	1986	2.4	9.6
Ecuador	1986	16.5	34.0
El Salvador	1988	15.4	26.8
Guatemala	1987	33.5	57.8
Guyana	1987	23.4	-
Haiti	1978	38.0	-
Honduras	1987	20.6	33.9
Jamaica	1985	14.6	-
Nicaragua	1987-1988	10.9	-
Panama	1980	15.8	25.1
Paraguay	1976	2.9	-
Peru	1984	13.4	37.8
Dominican Republic	1987	5.8	12.8
Trinidad and Tobago	1987	6.8	-
Uruguay	1987	7.4	-
Venezuela	1981	6.4	10.2

Source: Pan-American Health Organization (PAHO), Health Conditions in the Americas, vol. 1, Scientific Publication No. 524, Washington, D.C., 1990.

^a This table only aims to give orders of magnitude of the malnutrition problem and not to make strict comparisons between countries, since the coverage and methods of calculation differ from country to country. Global malnutrition is reflected in low weight; chronic malnutrition is reflected in low stature of the children.

^b 1981.

^c 1982.

4. Education⁵

Because of their effects on the productivity of human resources, on the formation of the modern citizen, on the capacity of the population to prepare and process demands, and on demographic behaviour, changes in education act as the central pivot of the whole set of changes which expand and make more attainable the population's opportunities of achieving greater well-being. Consequently, the objectives that the set of educational policies should fulfil and the relative effectiveness and efficiency of the different strategies for attaining such objectives must be the subject of careful reflection.

a) *The regional situation*

i) *Recent trends*

As already noted, the greater coverage and extension of education is one of the most striking features of the period since the war in Latin America (see table VIII-5). During this period the illiteracy rate went down drastically from almost 50% in 1945 to 15% in 1990; the rate of primary school attendance almost doubled and in many countries (although not in all) it is not far from reaching total coverage; and enrolment rates in secondary and higher education increased more than fivefold, so that new strata of the population gained access to what until mid-century had been the privilege of only a small élite (of the order of 10% of the population for secondary education and 2% for higher education).

Despite this enormous progress, however, the average length of schooling in the region is still only six years, and almost half the labour force has not completed primary education. Moreover, many countries have educational levels which are significantly lower than this, and in almost all the countries the rural areas lag far behind the national averages. Likewise, in spite of the progress in quantitative terms, generally speaking the quality and efficiency of

the system leave a good deal to be desired. Suffice it to mention in this respect the high proportion of students who have to repeat courses (one of the highest proportions in the world), which means that although the average primary school student remains in the system for between six and seven years, he only successfully completes four or five grades (to say nothing of the possible slackening of requirements and the corresponding "padding" of marks).

With the crisis of the 1980s per capita public spending on education went down markedly, recovering only partially in the second half of the decade. Thus, at the end of the 1980s the level of such expenditure was still nearly 30% below that of 1980, although there was a big disparity between the various countries (see table VIII-6). Although the crisis did not stop the quantitative expansion of educational coverage, in most cases there was a decline in teachers' wages, in the availability of teaching material, and in maintenance expenditure, so that the shortcomings of the educational processes in terms of quality became still more marked.

ii) *Two great shortcomings of the educational system*

a. *A low-quality educational system incapable of meeting the needs of development.* One of the factors which explains the above-mentioned quantitative expansion of the educational systems at the expense of their quality is the explosive growth of social demands with regard to education. These demands gave rise to a disorderly race to make progress in which formally higher levels and grades were incorporated without at the same time redefining the content of the educational process or increasing the resources in line with the increased enrolments. The traditional political preference for material (i.e., visible) investments rather than those having a greater qualitative effect, and the low priority given to education until recently by the productive system, also helped to give the growth of the

Table VIII-5

LATIN AMERICA AND THE CARIBBEAN: INDICATORS OF THE EDUCATIONAL SYSTEM

	Illiteracy (as a percentage of the population 15 or more years old around 1990)	Percentage of completion of primary education ^a	Gross rate of enrolment in higher education ^b	Percentage of the population living in urban areas (around 1990) ^c
LATIN AMERICA				
Uruguay	3.8	-	41.6	85.5
Argentina	4.7	-	38.7	86.2
Cuba	6.0	91.0	20.9	74.9
Chile	6.6	85.0	17.9	85.6
Costa Rica	7.2	79.0	24.8	53.6
Paraguay	9.9	-	-	47.5
Venezuela	11.9	59.0	28.0	90.5
Panama	11.9	82.0	21.0	54.8
Mexico	12.7	68.0	15.8	72.6
Colombia	13.3	-	13.5	70.3
Ecuador	14.2	62.0	-	56.9
Peru	14.9	70.0	30.8	70.2
Dominican Republic	16.7	-	-	60.4
Brazil	18.9	-	10.7	76.9
Bolivia	22.5	-	17.7	51.4
Honduras	26.9	-	6.9	43.6
El Salvador	27.0	33.0	17.7	44.4
Guatemala	44.9	47.0	8.6	42.0
Haiti	47.0	31.0	0.7	30.3
CARIBBEAN				
Barbados	0.5	-	18.7	44.8
Jamaica	1.6	82.0	4.5	52.3
Guyana	3.6	84.0	2.1	34.6
Trinidad and Tobago	3.9	78.0	-	69.1

Source: Economic Commission for Latin America and the Caribbean (ECLAC), Statistical Yearbook for Latin America and the Caribbean 1990 (LC/G.1651-P), Santiago, Chile, March 1991. United Nations publication, Sales No. E/S.91.II.G.1.; and United Nations Educational, Scientific and Cultural Organization (UNESCO), Evolución cuantitativa de los sistemas educativos de América Latina y el Caribe: Análisis estadístico, Paris, 1986.

^a Figures for 1982.

^b Number of persons aged 20-24 enrolled in post-secondary education, as a percentage of the total population aged 20-24.

^c The definition of the urban population is that used by each country.

Table VIII-6

**LATIN AMERICA AND THE CARIBBEAN: PER CAPITA EXPENDITURE
ON EDUCATION, BY SUB-PERIODS^a**

Countries	Real indices (base 1979-1981 = 100)	
	1982-1985	1986-1988
Argentina	80.68	73.86
Barbados ^b	n.d.	n.d.
Bolivia	73.93 ^c	52.39
Brasil	96.60	157.93
Chile	94.69	84.11
Costa Rica	67.51	84.92
Ecuador	89.41	84.28
Guatemala ^d	62.20	101.68
Mexico	94.59	72.78 ^e
Panama ^b	114.13	120.57
Paraguay ^b	95.13	75.60 ^f
Peru ^b	133.23	142.50 ^f
Dominican Republic	92.52	81.41
Uruguay	76.59	88.89
Venezuela	90.48	87.99 ^e

Source: Prepared by the ECLAC/UNDP Regional Project on Fiscal Policy, on the basis of data from the IMF.

- ^a Includes both expenditure and net loans by the central government. Covers only the school-age population between 5 and 24 years of age.
- ^b Does not include net loans.
- ^c Average for the period 1982-1984.
- ^d No data available for 1980.
- ^e 1986 only.
- ^f Average for 1986 and 1987.

educational system a disordered nature, without proper implementation, as well as leading to inefficient use of the capacity of the system. All this drastically affected the quality of the results obtained.

It is at the primary educational level that these shortcomings in terms of quality have the most serious repercussions, since they adversely affect the results of the other levels of education in a kind of chain reaction, as well as constituting a serious hindrance to the economic, political and social development of the region. The low quality of primary education is reflected in high rates of late entry, repetition of courses, temporary dropouts, and premature final abandonment of the system. Through the combined effect of these four factors, half the children drop out of school before completing their primary education, and a significant proportion are functional illiterates in the sense that at the end of their schooling they still do not have minimal capacity to read and understand written texts, to communicate in writing, or to carry out simple calculations.

This serious shortcoming in the teaching of basic skills is aggravated by the problems caused by the total separation between the needs of development and the educational systems used. These problems are generally manifested in the following forms: the weakness of basic training—above all in reading, writing and mathematics—and the absence of practical knowledge in primary and secondary education; the survival of an encyclopedic-type form of education, typical of pre-war humanism, aimed solely at preparing for entry to the university and hence totally divorced from the world of work; the progressive obsolescence and growing rigidity of administration of the technical and professional training circuits; the rapid and disorderly growth of the post-secondary educational system, with a multitude of establishments often offering programmes of doubtful quality and giving little place to scientific and technological courses; the absence at all levels of incentives for the formation of rational and critical habits of thinking; and the very limited sensitivity of the educational

systems to present-day society, technology and forms of organization and expression, as well as to the foreseeable lines of change during the twenty-first century.

b. *A style of growth that leads to inequity, differentiation and segmentation.* This expansion in quantitative terms has been accompanied by a failure to pay much attention not only to quality but also to equity. Thus, the universalism of the system has been apparent rather than real, achieved at the expense of the necessary improvement of quality of the vast majority of establishments dealing with the needs of children of the popular sectors. Although the situation varies significantly from one country to another, generally speaking there has been uneven and heterogeneous evolution of the various levels of education in such establishments, giving rise to a veritable "social division of educational labour" between the public sector and private sector establishments and also among the public sector ones themselves: a few good-quality establishments for the middle-class sectors, with the remainder in a deplorable state. This has given rise to segmented educational circuits treating the various social groups according to their level of income.

The majority of the population only have access to low-quality education. This is reflected not only in the high percentages of repetition of courses and dropouts and the pathetically low performance of these sectors in national examinations, but also in big differences even within this sector of the population, especially in the case of rural areas, indigenous communities and the inhabitants of marginal urban areas. Table VIII-7, for example, shows that the children of families in the lowest income quartile with a "low family educational climate"⁶ register between two and three years of formal schooling less than the children of families in the economically and socially highest quartile and of course, much fewer years of higher education. Likewise, as may be seen from table VIII-8, the percentage of young people between 15 and 19 from the "low" economic and social stratum who drop out of school with less than six years'

Table VIII-7

SELECTED LATIN AMERICAN COUNTRIES: SOME INDICATORS OF ACCESS
TO EDUCATION AND EDUCATIONAL PERFORMANCE, BY FAMILY
EDUCATIONAL CLIMATE AND GEOGRAPHICAL AREA

Country/ year	Area	Percentage of children between 3 and 5 attending pre-school educational establishments		Percentage of children between 6 and 14 not attending formal educational establishment		Percentage of children between 7 and 14 who are behind in their formal education		Average number of years of schooling of children between 10 and 14	
		Low ^a	High ^b	Low	High	Low	High	Low	High
Argentina 1986	Metro- politan Area (MA)	- ^c	-	-	-	-	-	3.3	6.2
Brazil 1987	MA	39.7	86.4	7.6	0.0	48.3	3.9	2.8	4.6
	Urban	36.9	84.4	8.4	0.4	59.5	6.0	2.2	4.5
	Rural	18.9	60.5	10.3	-	76.7	3.6	1.4	4.2
Colombia 1986	MA	-	-	21.6	3.7	52.6	16.7	2.8	5.1
	Urban	-	-	24.4	3.2	61.4	11.1	2.5	5.1
Costa Rica 1988	MA	-	-	21.8	11.9	36.6	8.8	2.7	5.2
	Urban	-	-	19.9	4.0	38.9	4.5	3.2	5.7
	Rural	-	-	31.7	11.7	48.8	8.6	2.9	5.0
Uruguay 1989	MA	25.0	89.8	3.3	0.0	44.3	3.1	3.4	5.8
	Urban	21.0	83.6	8.1	1.6	27.3	1.1	4.4	6.0
Venezuela 1986	MA	16.5	47.3	19.0	1.2	44.9	20.5	2.9	5.7
	Urban	16.7	49.4	15.9	1.5	45.9	14.6	3.1	5.9
	Rural	10.6	47.2	24.9	2.4	53.6	17.5	2.5	5.6

Source: Economic Commission for Latin America and the Caribbean (ECLAC), Panorama social de América Latina (LC/G.1688), Santiago, Chile, 31 October 1991.

- ^a Low stratum = average of less than 6 years' schooling for family members aged 15 or more.
- ^b High stratum = average of over 10 years' schooling for family members aged 15 or more.
- ^c Data not available.

Table VIII-8

SELECTED LATIN AMERICAN COUNTRIES: SOME INDICATORS OF ACCESS TO
EDUCATION AND EDUCATIONAL PERFORMANCE, BY FAMILY EDUCATIONAL
CLIMATE AND GEOGRAPHICAL AREA

Country/ year	Area	Percentage of young people between 15 and 19 who are not studying and completed less than 6 years' schooling		Percentage of young people between 20 and 24 who are not studying and completed less than 10 years' schooling		Average number of years of schooling of young people between 15 and 24	
		Stratum Low ^a	Stratum High ^b	Stratum Low	Stratum High	Stratum Low	Stratum High
Argentina 1986	Metropo- litan Area (MA)	5.3	0.0	60.2	21.4	8.0	10.9
Brazil 1987	MA	34.4	2.8	73.8	13.0	5.7	9.9
	Urban	42.2	7.6	69.1	24.7	4.9	8.8
	Rural	65.8	49.2	86.4	78.8	3.3	5.5
Colombia 1986	MA	17.3	14.5	61.8	19.8	7.4	10.0
	Urban	25.8	19.8	68.8	29.4	6.8	9.1
Costa Rica 1988	MA	16.7	1.3	66.9	22.6	7.6	10.5
	Urban	11.6	1.7	64.1	26.9	7.4	10.1
	Rural	22.6	11.9	80.3	65.1	6.2	7.4
Uruguay 1989	MA	3.7	0.7	60.4	17.1	8.3	11.0
	Urban	8.3	3.4	71.9	36.5	7.8	9.7
Venezuela 1986	MA	9.4	2.1	54.0	24.9	7.9	10.8
	Urban	11.8	5.1	63.2	42.0	7.5	9.2
	Rural	33.7	27.3	85.7	74.6	5.2	6.6

Source: Economic Commission for Latin America and the Caribbean (ECLAC), Panorama social de América Latina (LC/G.1688), Santiago, Chile, 31 October 1991.

^a Low stratum = average of less than 6 years' schooling for family members aged 15 or more.

^b High stratum = average of over 10 years' schooling for family members aged 15 or more.

schooling is high (it reaches as much as 50% or so in Brazil) and is between 3% and 30% more than in the "high" stratum.⁷

All these are clear signs of the very unequal opportunities for gaining access to the various levels of the educational system and completing it with a minimum of educational attainments. Thus, instead of receiving preferential attention designed to make up for their lower family social and cultural level or their lower degree of family organization, these groups usually receive even worse attention than the average, and their underprivileged position in this respect has helped indirectly to finance the extension of education to higher levels to which, in practice, they have only nominal access. Another point which should be mentioned with regard to factors which are of importance in determining educational attainments, in addition to the quality of the educational system and the income and level of education of the parents ("the educational climate"), is the degree of "organization" of the family. Thus, a study of urban areas in four countries⁸ (see tables VIII-9 and VIII-10) reveals that students from families with a lower degree of organization—that is to say, children of unmarried parents or from households where the father is not present—register educational attainments between 10% and almost 50% lower than those of nuclear households with legally married parents. It should be noted that this is a still further lag, *after* having taken into account the effects of the economic and social stratum and family educational climate.⁹ From the point of view of the children, the greater stability and potentially more responsible parenthood associated with a legal marriage and the presence of both parents is so important that frequently the children of legally married parents in the low income quartiles register educational attainments which are higher than those of the children of unmarried parents in higher income quartiles. Consequently, as the frequency of unmarried parents and households where the father is absent is usually greater in the low economic and social strata, it is even more important to give preferential and additional

attention to these households and to promote policies aimed at stimulating and strengthening more stable relations of couples.

b) *Policies for educational reform*

A reform strategy for integrating education into changing production patterns with equity in a context of democracy requires the fulfilment of two essential criteria: equity and performance. The first criterion covers equality of opportunity, action to make up for differences, balanced development and cohesion of the social body as a whole, while the second covers efficacy (targets) and efficiency (means), evaluating performance and promoting innovation.

In order to attain these objectives, a set of guidelines is proposed which, at the central level, strengthen the institutional capacity of the countries to guarantee the quality of education, equality of opportunity and the integration of all citizens into common codes, values and capacities, while at the local level they are designed to promote the decentralization and autonomy of educational establishments so that they can carry out educational programmes with a greater degree of identity, responsibility for the results and efficacy in the allocation of their resources, in a climate of continual openness to and interaction with the economic and social environment in which they operate.

i) *Universal access to modern education*

a. *Expansion of programmes of preschool attention.* Most studies agree on the importance of programmes of preschool attention and early stimulation for the subsequent educational development of children. Their effect is particularly beneficial for children from poor households with a low potential for stimulation, since they facilitate the subsequent benefit they can derive from formal education. It may be noted that access to preschool education for children between three and five years of age is

Table VIII-9

SELECTED URBAN AREAS OF LATIN AMERICA, 1985-1990: EDUCATIONAL
PERFORMANCE OF CHILDREN AGED BETWEEN 10 AND 14 WHOSE
PARENTS COHABIT BUT ARE NOT LEGALLY MARRIED^a

Strata ^{b c}	Countries			
	Colombia	Costa Rica	Uruguay	Venezuela
C1-E1	73	74	72	81
C1-E2	86	87	89	91
C1-E3	93	98	89	91
C2-E1	71	- ^d	-	82
C2-E2	95	94	105	93
C2-E3	93	105	98	98
C3-E1	81	-	-	76
C3-E2	99	75	-	94
C3-E3	97	110	109	94
C4-E1	-	-	-	58
C4-E2	76	-	-	89
C4-E3	80	100	83	98

Source: ECLAC, on the basis of household surveys of the countries.

^a The base of 100 is taken to be the performance of children of the same age living in households where the parents are legally married.

^b C1 = first quartile of per capita income of household; C2 = second; C3 = third, C4 = fourth quartile.

^c E1 = educational climate of household between 0 and 5.99 years' schooling on average; E2 = between 6 and 9.99 years; E3 = average of 10 or more years' schooling.

^d - means that the sample was not big enough to estimate the variable with a sufficient degree of reliability.

Table VIII-10

SELECTED URBAN AREAS OF LATIN AMERICA, 1985-1990: EDUCATIONAL PERFORMANCE
OF CHILDREN AGED BETWEEN 10 AND 14 FROM HOUSEHOLDS
HEADED BY A WOMAN ALONE^a

Strata ^{b c}	Countries			
	Colombia	Costa Rica	Uruguay	Venezuela
C1-E1	79	- ^d	71	88
C1-E2	90	87	89	94
C1-E3	93	96	99	94
C2-E1	92	-	-	77
C2-E2	90	95	98	96
C2-E3	96	79	107	103
C3-E1	98	-	-	71
C3-E2	106	-	-	96
C3-E3	99	114	99	101
C4-E1	-	-	-	-
C4-E2	85	-	-	106
C4-E3	91	91	115	100

Source: ECLAC, on the basis of household surveys of the countries.

^a The base of 100 is taken to be the performance of children of the same age living in households where the parents are legally married.

^b C1 = first quartile of per capita income of household; C2 = second, C3 = third; C4 = fourth quartile.

^c E1 = educational climate of household between 0 and 5.99 years' schooling on average; E2 = between 6 and 9.99 years; E3 = average of 10 or more years' schooling.

^d - means that the sample was not big enough to estimate the variable with a sufficient degree of reliability.

extremely insufficient, and moreover, attendance by children from the low economic and social stratum is only between half and a quarter that of attendance by children from the high economic and social levels (see table VIII-7).

Although the ideal is to begin from two years of age onwards, it is more practical in view of the available resources to begin with children aged five and gradually incorporate children of younger ages, with the efforts centered on children from low-income areas and households (because these are the children which have the greatest need to supplement their low environmental and family cultural level).

b. *Universal good-quality coverage for basic education.* For many young people in the region, basic education is the last training they will get. The growing importance of information in modern society and the changing nature of knowledge, however, require that all persons should be trained to learn from the multiple channels of communication and hence of education which exist in that society. This is why it is important to ensure that all persons receive primary education of a sufficiently high level of quality to permit such future learning processes. For this purpose it is necessary to make the coverage of basic education universal and drastically reduce the number of dropouts, repetition of courses and other phenomena which prevent the effective access of all the children enrolled in primary schools to the fundamental skills needed to develop in society. In some countries there are still serious shortcomings with regard to coverage, generally in isolated and poor rural areas. In these cases, the extension of coverage, with corresponding investment in infrastructure and the recruitment of teachers, is an unavoidable priority.

In order to strengthen the development of basic and scientific aptitudes, it is necessary to strengthen the teaching methods, the curricula and other materials associated with the teaching process, and to ensure that they are properly applied. This is particularly important in the case of children from households with the least resources and the lowest educational climate, since it is here, as shown by the results of

standardized performance evaluation tests, that the problems with regard to development of basic aptitudes are most heavily concentrated.

There is generalized recognition of the need for a radical review of traditional teaching methods, with their emphasis on passive and repetitive teaching and their high level of failure. Particular attention must be paid to the methods for teaching, reading, writing and mathematics in schools attended by children with a cultural background different from that demanded by the school (see box VIII-3). In this respect, particular importance must be assigned to programmes of bilingual education, for various studies have shown that among children whose mother tongue is different from the official language, the use of the former, at least in the early years of schooling, combined with progressive introduction to the second (official) language, facilitates the learning process of children from these groups.¹⁰

With regard to organization of the curriculum, various studies¹¹ and examples of experience indicate the desirability of considering the reorganization of curricula in terms of learning cycles, departing from the traditional practice of dividing up studies on a yearly basis and introducing progressive modular curricula which give the teacher or the team of teachers a margin to adapt to the learning rate of each child.

The availability of textbooks is one of the factors which makes the greatest contribution to the improvement of scholastic performance in primary education. Generally speaking, the aim of the countries should be that each student should have the necessary school books for the main subjects covered by the programme. In order to attain this objective, it may be that in a first stage the State may have to make a free distribution of school books to public and subsidized schools. Another option would be to give schools or families a subsidy for the purchase of such books, graduated according to the geographical area and the income level of the families. This option has the advantage of focusing fiscal expenditure more effectively, but the disadvantage of requiring greater public

Box VIII-3

**THE ESCUELA NUEVA: A NATIONAL-LEVEL EXPERIMENT IN
PERSONALIZED EDUCATION**

A Colombian experiment has shown that it is feasible to substantially raise the quality of primary education for relatively modest increases in the unit cost per student. The Colombian *Escuela Nueva* is now functioning in 20 000 rural schools with one or more teachers, and the evaluations made show that the students of these schools turn in higher levels of academic performance than those of traditional schools. Greater self-esteem and motivation to work have also been achieved.

This model has succeeded in changing the role of the teacher. In these schools, the teacher no longer has to spend almost all his time in transmitting instructions or knowledge, often written down in a text, but instead must ensure that every student is taking an active part in a learning experience. For this purpose, the students are given self-training texts containing detailed instructions on each of the steps that must be followed in order to achieve a learning experience of real value. These instructions do not constitute the source of knowledge in themselves, but are rather the "map" of the road that the student must follow in order to arrive at the treasure of personal knowledge. These instructions are imparted directly to each student, who then studies them together with a group of three or four schoolmates, and they only turn to the teacher when there is some difficulty in understanding part of them. This greatly reduces the time now used by the teacher to "transmit" instructions either verbally or by writing them on the blackboard. This is particularly valuable in a region where the annual number of hours of teaching are only one third or less compared with schools in developed countries and where there are teachers without formal teacher training (the texts make it possible to ensure certain minimum levels for the learning experiences).

One of the main contributions made by the Colombian experiment has been the design of a new type of modular self-training text. Each text has detailed instructions which make the student examine a local reality or a text and analyse it (first of all alone, and then in a group) from the points of view suggested by the instructions, those that occur to the students themselves, or those suggested by the teacher. The students have to write down the result of each analysis for examination in the group and subsequent comparison with what it says in the text, in order to identify the other aspects which were not taken into account at this time. Once all these stages suggested in the text have been completed, the teacher must evaluate the final result of the group work in order to decide if it is necessary to carry out other activities or if they can go on to the next module. Eventually, the students become proficient in a non-memory-based method of learning, and the teachers become true guides for the students' research. Students who have gone through this kind of training are not afraid to face new situations, because they have exercised and developed their capacity to identify problems, seek and process information, and write down the results of their process of enquiry. Moreover, as the students ask their parents for items of information for their work (local songs, tales and sayings, ways of preparing food, illnesses, methods of work, forms of transport, dances, and the raising of animals or plants), the parents themselves usually become interested in the work of the school and cooperate more willingly when the teacher asks them to.

The process of putting the *Escuela Nueva* into practice has been systematized, and it is now applied in 20 000 schools. This systematization would naturally facilitate its application in other countries. Although the texts used must be adapted to each country, the method of giving instructions, which is designed to take account of the local environment, facilitates their adaptation. The materials required are provided by the community or collected by the students, except in the case of the work tables or desks, which must have a flat top and must be movable in order to facilitate the group work. The teachers are trained at three seminars, each lasting one week, which are carried out when they fulfil some very specific requirements on community participation or work with the students. The programme is kept up through periodic visits to the demonstration schools and monthly meetings of the teachers at "microcentres" where they discuss the problems of putting the programme into practice and study further advances in the technology used.

Source: Ernesto Schiefelbein, *In Search of the School of the XXI Century. Is the Colombian Escuela Nueva the Right Pathfinder?*, Santiago, Chile, UNESCO Latin American and Caribbean Regional Office for Education (OREALC) and UNICEF Regional Office for Latin America and the Caribbean, 1991.

administration capacity. At all events, the cost of a policy of this type would represent only a minimal percentage of current expenditure on education, as may be seen from the example of countries where similar policies have been put into effect.¹²

Education in a modern society calls for the establishment of an "access relationship" with knowledge. This involves, particularly at the secondary level, the incorporation into the school of educational agents who, while not teachers, have certain kinds of knowledge and are in a position to share it; the "release" of students in order to gain access to the knowledge that can be derived from practical work, institutions and experience; and the systematic use of libraries, the press and the other communication media. The spread of the communication media, in particular, has progressed so far in the region that their existence must be integrated into any future educational strategy.

c. Increasing the length of the school day and encouraging attendance. One reason why present-day education achieves only low levels of performance is the short school day compared with the needs and possibilities of the students, together with the high level of absence and dropping out by children and adolescents, especially those from the poorest families. Among the possible measures for dealing with this situation are the following: i) the adoption of the international minimum standards of 880 class hours per year, but with the school calendar adapted to the requirements of the local economy, especially in rural areas (for example, by not having classes on days when there are fairs or harvesting is in progress); ii) the establishment of direct incentives for attendance (for example, through the operation of school dining-rooms and the provision of health services in low-income school areas); iii) the linking of public financing for schools, under certain conditions, both to the effective number of student-days registered and the number of students passing a national examination at the end of a cycle or after a certain number of years, *taking due account of their initial cultural*

level; and iv) carrying out campaigns to make the public aware of the benefits of education, complemented by similar action in favour of the enrolment of children in preschool education.

d. Programmes to strengthen basic aptitudes in adults. In various countries of the region, a wide segment of the population is either absolutely or functionally illiterate¹³ and is consequently totally or partly excluded from the processes of social integration and modernization of the economy. In order to prevent this differentiation from getting still worse in the years to come, it is necessary to organize programmes of literacy training and strengthening of the basic schooling of adults which link these training activities with the students' social and economic environment.

The timetables for such literacy and educational strengthening programmes (many of which are already underway) must likewise be in keeping with the working needs of the adult, that is to say, they must normally be given in the evening. This would not only make it possible for persons who have jobs to take part in these classes but would also put them in a better position to finance part of their studies. Moreover this would mean making better use of the physical facilities of the educational establishments.

ii) *Establishment of an educational system open to the needs of society*

It is proposed to overcome the current isolation of the educational system with regard to the needs of society by opening it up to the demands of daily life and the world of labour practices by integrating educational units, at all levels of the human resources training system, with the real environment or surroundings and coordinating these units with each other, multiplying the linkages, points of entry and exit and, in general, their capacity for establishing horizontal and vertical relations both within the system and with society. In order to advance in this direction, it would be necessary to give the establishments autonomy, generate flexible

mechanisms for their regulation, and multiple levels of coordination and concertation. Achieving greater openness of the educational system will undoubtedly call for strategic national agreements for putting the necessary measures into practice.

a. Autonomy of educational units.

Decentralization is seen in two senses: firstly, as a shifting of the management responsibilities for the establishments from above to below, until they are located in each educational unit, which thus acquires autonomy for making innovations and adapting to its environment, and secondly, as a means of control by the central authorities, in order to promote quality and equity on the basis of the results obtained and not centralized bureaucratic control over the teaching "inputs".

The detailed, minute and uniform control currently exercised over schools by centralized State bodies could be replaced by a system providing for the autonomous local management of educational establishments, with effective central regulations adopted in the light of the overall objectives and minimum requirements of a national nature. The greater flexibility offered by this institutional system for defining educational plans and programmes would make it possible to diversify and hence enrich education by taking advantage of the stimuli and challenges provided by the surrounding environment.

Autonomous management of each establishment would give the team of teachers and their director competence to define the educational project pursued by their establishment, within the framework of national policies and priorities, assuming responsibility for the handling of the academic, administrative and financial aspects of the project. In order to ensure that the educational project and its execution are in keeping with the needs of the local community, the team running the school should be responsible for the project under the authority of a board of management of the establishment on which the local authorities, the parents of the students, and other members of the community could be represented.

At the same time, in order to ensure fulfilment of overall objectives and, in particular, minimum quality requirements, national-level bodies would be responsible for fixing the global development policies, defining the objectives and minimum content of the programme syllabuses, allocating public resources in order to ensure the quality and equality of opportunities of the system, compensating for imbalances which may exist in the system, and establishing mechanisms for measuring the educational performance of the establishments.

The best means for ensuring the internal and external efficiency of a decentralized system is an effective system of information on and evaluation of scholastic and academic performance (see box VIII-4). The results of this monitoring give users proper grounds for demanding higher quality from the establishments, help the latter to improve their performance, and assist the authorities in concentrating their action on those schools where the level of performance is lowest and thereby affects the equity of the system as a whole. In the final analysis, such evaluation is a powerful means for implementing policies aimed at greater equity and improving the quality of educational and training activities. It is also an essential element both for the evaluation of performance by the local teaching authorities and for the exercise of control by the central authorities.

At the same time, however, it must be recognized that decentralization does raise some problems. On the one hand, decentralization has not always been associated with higher levels of autonomy of the individual establishments, for some educational decentralization programmes in the region have been programmes for promoting administrative and political deconcentration rather than actual autonomy, and the innovations which could be made in the content and practice of teaching have only been taken into account in a very subsidiary manner.

Moreover, decentralization processes frequently run into obstacles, and it is important to take these into consideration in order to try to

Box VIII-4

SYSTEMS FOR MEASURING THE QUALITY OF BASIC EDUCATION.
SOME REGIONAL EXPERIENCES

The System for Measuring the Quality of Education (SIMCE) in Chile and the Information System on the Quality of Mexican Education (SICEM) are two periodic and systematic information systems which make it possible to identify and detect on a regular basis the problems affecting the quality of education.

SICEM was applied for the first time, on an experimental basis, in 1987 and subsequently, more extensively, in 1988, at the fourth and sixth grades of primary education. It seeks to measure four types of specific variables: formative aspects, the process of education and learning, operational support for the educational system, and the response of education to economic and social development. SICEM uses a methodology designed to evaluate the presence of a particular educational objective in the teachers' minds, as a function of their own personal evaluation. In order to corroborate certain variables and to go more deeply into the more subjective aspects, a sample survey is carried out, and in 1988 this was applied to 5 500 students and 420 teachers.

The special features of SIMCE are its massive application and the broad dissemination of its results, in keeping with its function as an instrument to promote autonomous action tending to favour the improvement of the quality of education. Instead of defining a single reference of educational quality, SIMCE gives different indicators which each agent can weigh in accordance with his own criterion in judging actual conditions. In 1988, the measurements carried out covered five quality indicators: achievement of academic objectives, personal development, recognition given to educational work, scholastic efficiency, and coverage.

However, it is the first of these indicators which receives most attention, since it measures the quality of education as a function of the achievement by the student of the objectives proposed by the educational system for him in different subjects. It is measured through tests of performance in mathematics, Spanish and composition, social sciences and natural sciences, applied to students of the fourth and eighth grades of basic education. The contents included all those considered to be of fundamental importance in the curriculum.

The UNESCO Latin American and Caribbean Regional Office for Education (OREALC), for its part, has prepared a draft system of measurement of the quality of basic education in the region which, as well as measuring the performance of the students in scholastic matters, also makes it possible to determine how the various dimensions of the educational system affect scholastic performance and, thereby, provide guidance for corrective action. In addition, instruments have been designed with the aim of establishing a common set which could be adapted to the different cultural, social, economic and educational conditions in Latin America and the Caribbean, in order to collect information on educational quality in the region and generate soundly-based knowledge on the subject. For the measurement of learning achievements in the first, second and fourth grades of basic education, the areas of language and mathematics were selected. This measurement of the knowledge gained is supplemented with a test of social skills, designed to measure the acquisition of skills which will be useful to the students in their daily life.

design more effective policies. Firstly, the limited and unequal distribution of management capacities will be reflected in serious shortcomings in the case of certain establishments which will limit their capacity to take advantage of the change. The central authorities must therefore carry out a supplementary or subsidiary function of providing technical and financial support in order to ensure that such educational establishments carry out their functions in an "active" manner and do not become mere cultural reproducers of the community (see

box VIII-5). In effect, the application of a policy for giving greater autonomy to the establishments in a context of inequality of opportunities calls for a strong central authority which can ensure a certain minimum level of quality and correct inequalities with regard to access and quality, while at the same time voluntarily limiting its field of action so as not to interfere with the work of the local communities.

A second obstacle has been the lack of congruence between legal rules, the inflexible nature of the existing regulations, and the

Box VIII-5

THE LEARNING PROCESS AND THE SOCIO-CULTURAL LEVEL OF THE FAMILY

The results of a recent study on the Uruguayan school system and the unequal learning performance observed among children as a function of the geographical, economic and social position of the school they attend illustrate the risk that the decentralization of decisions may encourage the dominance of the community over the establishments, which, in the most underprivileged communities, could have negative effects on educational performance. In the study it is concluded, *inter alia*, that the more heterogeneous is the socio-cultural composition of the schools, and the greater the participation of families with higher levels of education, the greater is the learning performance of children of the lowest educational origin, and when the model along the lines of which the system operates causes the school to influence the community through the children and their families (the "active" school), this reduces the original socio-cultural gap in the learning processes. If the opposite situation prevails, however, and the community affects the schools through the children and their families, then the lowest common denominator of the community tends to define the role of the school.

In order to avoid this type of effect, it is important that decentralization should be accompanied by a policy which ensures that the economically and socially weakest areas receive the necessary management assistance and ongoing evaluation in order to ensure that the local educational establishment not only reaches minimum levels of quality but is also capable of overcoming the limitations of the socio-cultural and family background of its students.

Source: ECLAC, ECLAC Office in Montevideo, Qué aprenden y quiénes aprenden en las escuelas de Uruguay. Los contextos sociales e institucionales de éxitos y fracasos, Montevideo, 1990, chapter IV, p. 99 *et seq.*

effectively limiting role of many of them. The only solution at this level is a careful study of the existing institutional structure, as a precondition for the design of the new organization.

Thirdly, as is only natural, the decentralization itself can also give rise to resistance. In this respect, it would be desirable, as a preventive measure, to design training programmes in advance and consider the possibility of bringing the representative bodies into the formulation of the new policy right from the beginning.

b. *Mechanisms for public regulation.* The greater autonomy of the establishments means that the State must have effective means of evaluating the fulfilment of goals and safeguarding the global lines of the system and its equity, so in an early stage the State itself must improve its capacity for regulating and guiding the system as a whole. With this in mind, it is important to strengthen the institutional capacity of the relevant public bodies for policy design, planning, and research and analysis, giving the necessary training to the staff and establishing

flexible information systems with decentralized access.

In order to encourage effective management of the establishments, it is essential to set up systems for periodic evaluation. This makes it easier for the heads of these establishments to take public responsibility for their management, while at the same time making it possible to identify potential problems and shortcomings and, possibly, to promoting a search for solutions at the local management level (see box VIII-4). Such systems also enable the central and local authorities to determine which establishments show the greatest shortcomings in their performance, to detect the main sources of inequalities in the system, and to decide on action to correct these situations.

c. *Arrangements for coordination and concertation.* The greater autonomy of the human resources training units needs to be accompanied by the establishment of multiple and effective arrangements for coordination and concertation, without which the system as a whole will lose coherence. The past experience of the region is rather poor in this respect. For example, the lack of coordination or points of

contact between the first cycles (preschool/primary and, subsequently, primary/secondary), even in centralized systems, is responsible for or at least accentuates many of the problems of learning.

In contrast, some form of separation should be promoted between secondary education and the university. There is no point in secondary education operating always with an eye to the university when only a small percentage of the students completing it enter university-level institutions. If such a separation is established, the secondary schools will be in a position to seek new ways of linking themselves with the social environment, each according to its own educational project.

As a counterpart to this separation between secondary education and higher education, a bridge should be created to fill the gap between secondary education and the labour market, possible through "dual" training programmes (see the section on training in chapter VI). Such a bridge can only be established through active concertation with regard to the educational project between those responsible for education, on the one hand, and the productive sector on the other.

Finally, there is a wide variety of areas which could benefit from international, regional and extra-regional cooperation. Among these, special mention may be made of the following: systems for measuring the quality and performance of educational establishments, which could be improved through the transfer and adaptation of systems and technologies developed in the industrialized countries; innovations in the curriculum, the training of teachers and the introduction of practices that link education and work at the level of secondary education; the design of mechanisms for accrediting the quality of higher educational establishments and the development of evaluation indicators and practices; the decentralization of educational systems and the strengthening of the autonomy of the individual establishments; support for experimental plans and pilot experiments in the field of technical training, at both the secondary and post-secondary levels;

research on processes, institutions and products of education and training; and the active exchange of teachers, academics, scientists and, in particular, students.

iii) *The professionalization of educators and the heightening of their role*

The two main requirements with regard to educators in an efficient system for training human resources —namely, the commitment to provide high-quality education and the capacity to carry out autonomous, responsible management of the establishments and resources for which they are responsible— illustrate the urgency of the professionalization of teachers. This must not lead, however, to the establishment of rigid attitudes with regard to the professional career: on the contrary, the objectives of the decentralization of schools and their insertion in the surrounding community call for educators who are themselves receptive to messages and demands from outside and are willing to work together with people from other professional spheres.

a. *The processes of recruitment and training.* The quickest and most efficient way of improving the professional capacity of the teachers currently working at the basic and secondary levels is to design special training programmes which are easily accessible to the teachers and are accompanied by a clear system of incentives. A good means of doing this would be to use distance training programmes combined with professional advisory services, as part of a curriculum leading to the award of a professional certificate (see box VIII-6).

The best processes for training teachers include training in teaching combined with periods of direct practice and flexible but stimulating spells of continuing upgrading. The establishment of regular discussion workshops, along the lines of the Colombian *Escuela Nueva*, where the teachers from an area meet every month to discuss their experiences, could be an interesting option if meeting centres and support personnel are available. For teachers in

Box VIII-6

THE LOGOS II PROGRAMME FOR TRAINING TEACHERS

Various Latin American and Caribbean countries have used some forms of distance training in order to train teachers, particularly in rural areas. The main advantage of teaching through radio, television or correspondence is that it makes it possible to reach schools located in the most distant areas, which are often precisely those that have the teachers with the least teaching and academic training. Distance training gives these teachers the possibility of completing training courses, after which they can sit for examinations to obtain a professional certificate and may thereby improve their income and receive professional recognition: a prospect which is generally attractive to them. Furthermore, distance training programmes for teachers make it possible to combine training with professional practice and substantially reduce the cost of training a dispersed population.

In Brazil, the Logos II programme offers correspondence courses to teachers who do not yet have professional certificates. These courses are supplemented with activities in local training centres. The programme combines the strengthening of curriculum material with training courses on teaching. The curriculum is divided up into modules or short courses on specific subjects. Each module is backed up with written material. The participants study the written material at home and come to the centre to carry out exercises and take tests. The centre also offers other activities, such as study and discussion groups, classes on special subjects, etc. The whole programme lasts from 30 to 50 weeks, after which the participants can sit for examinations to gain a professional certificate.

Source: Marlene E. Lockheed and Adriaan M. Verspoor, Improving Primary Education in Developing Countries. A Review of Policy Options, Washington, D.C., World Bank, 1990.

secondary education, whose material is subject to a continual and very rapid process of renewal and change, updating courses should be the rule. Teachers who speak indigenous languages should receive special training for bilingual teaching. Finally, the training of teachers in the use of the manuals and teaching support material selected at the local level should be established as a regular practice, since it has been shown that teachers who have not been trained to use the textbooks provided do not in fact use them, even when they are available.

Institutions of technical, professional and higher education, for their part, should have complete freedom to recruit their teaching staff. It is important, especially at the level of technical and professional training, that this staff should include experts coming directly from the productive sector. The mechanisms of accreditation and certification used should be such as to ensure the quality of the training provided by such professionals.

b. *Remuneration and incentives.* This topic forms part of the more general problem of

raising the economic and social status of public sector teachers, particularly in the basic and secondary cycles. Its solution is essential for the achievement of equity, since the quality of education depends largely on the degree of commitment and dedication to their calling displayed by the teachers. Quite apart from a sense of vocation, such commitment requires material stability, but this has been deteriorating markedly in recent decades, particularly in marginal urban areas and rural areas, where the effort required is greater and even more necessary for the achievement of equity. The payment of insufficient wages militates against the efficiency of education because it furthers loss of staff, moonlighting and a high turnover of personnel.

The determination of the level of wages which will make it possible to attract and keep efficient teaching staff depends on the educational profile of the available candidates and the alternative employment opportunities in each country. Inclusion of teachers' salaries in the general salary scale of the public

administration usually militates against flexible wage scales fixed at a genuinely competitive level.

One option for overcoming this obstacle is the use of systems of incentives and bonuses to supplement the basic salary. At present, these benefits are usually linked with seniority, and rarely with effective performance or the difficulty of the tasks carried out. This gives rise to the paradox that the teachers responsible for the most difficult classes are often young professionals with less experience and low wages. It is particularly important, then, to design a system of incentives which ensures that teachers are paid to a substantial extent according to the performance of their students (taking account, of course, of the initial level of the latter) and their participation in special programmes (such as those for the provision of special attention to lagging establishments) or in underprivileged areas, in order to attract experienced and highly motivated teachers to those programmes.

c) *Economic and political viability*

In line with the criteria set forth in this document, the financing policies adopted could follow two approaches aimed at improving the quality and equity of the educational system:

i) The use of mechanisms based on competition for the allocation of part of the public financing, in order to encourage institutions to improve their levels of quality and efficiency and promote rational use of the available resources;

ii) The use of selective mechanisms for the allocation of a further part of public financing which reflect the aims of increasing the equity of the system by compensating for the existing inequalities.

The precise forms of action used, as well as the extent and sequence of the measures making up the strategy for changing educational systems, will vary according to the individual countries, their initial situation and their future requirements, their institutional organization,

and their relative priorities; likewise, the cost of the measures and the terms of the choice among the potential means of financing will also vary from one country to another. Notwithstanding this natural difference between countries, however, we shall try here to establish an order of magnitude of the extraordinary resources that would be needed to take care of the main aspects of such reform in an "average country".

The region currently devotes approximately 7.5% of its GDP to education: between 4% and 4.5% of this corresponds to public expenditure, and between 3% and 3.5% corresponds to outlays by households (in the form of spending on texts, school materials, transport, and the cost of private education). The proposed strategy—which aims by the year 2000 to increase by 50% the number of students graduating from the primary and secondary cycles, substantially raise teachers' wages, offer preschool attention to the bulk of the poor children in the region between three and six years of age, provide scholarships at the secondary level for 25% of the poorest students with good marks, eliminate functional illiteracy, offer breakfast or lunch to all poor children in basic education, and finance the necessary institutional restructuring—requires spending on education to be increased by the order of 2.3% of GDP.¹⁴ If this increase is added to the 7.5% of GDP currently devoted to this sector, this gives total spending on education of around 10% of the product, which is comparable to the figures for some industrialized countries but below the efforts made by the Republic of Korea and the Chinese province of Taiwan.

Educational reform will transform the quality and equity of the educational system, and hence the rate and direction of Latin American development, in less than a generation. Nevertheless, its cost—2.3% of GDP—is substantial and amounts to some 50% of current fiscal spending on education. As the reform calls for a *stable and lasting financial commitment* it is important to show that it is feasible to obtain such financing. There are three factors which can make this objective attainable:

i) Thanks to the sharp decline in fertility in the last two decades in most of the countries of the region, the school-age population will only grow by around 10% in the next ten years. If fiscal income grows at the same rate as GDP during that period (i.e., by 50%, if GDP grows at an average annual rate of 4.1%), then by the tenth year there would be a considerable reduction in spending on education because of this decline in fertility. In other words, by the end of the decade, the decline in fertility itself (which will naturally vary from one country to another) will enable the authorities to cover almost half the resources needed for the reform.

ii) Higher education usually absorbs between 20% and 25% of total spending on education. The cost to the authorities could be substantially reduced if the real cost of such education were charged to the students—at least in the case of those courses where the market causes their higher productivity to be reflected in higher income—and loans or scholarships were given to those students who needed them (see the section on the creation of a market for investment in human resources in chapter VII).

iii) The reform can be carried out gradually. It is important, however, to bear in mind the opportunity cost with regard to production, well-being and equity involved in the postponement of the reform and in keeping unchanged the current system of education, training and investment in science and technology, with its striking shortcomings. By way of example, an approximate calculation may be made of the cost of the inefficiency of primary education in Latin America and the Caribbean by using the wage differentials between those who have completed primary education and those who have not, as a substitute variable for their productivity differential. When this differential is multiplied by the proportion of persons with incomplete primary education in the adult economically active population, the conclusion reached is that the rise in the educational level of these workers, *ceteris paribus*, would lead to an increase in GDP of a little over 1% in countries with broad educational coverage such as Costa

Rica and Uruguay, and as much as 17% in the case of Brazil, where a high percentage of the active population has very little education. In contrast with this potential, the cost of improvements in the quality and coverage of education (0.5% of GDP), extensive programmes of adult education (0.1%) or readjustment of teachers' wages (0.6%) seems quite a modest outlay.

In short, the time is ripe for setting about the application of a new strategy aimed at radically improving the education and training of future generations. This would help to improve both competitiveness and equity, since it would simultaneously give rise to increases in productivity and wages, as well as giving greater equality of access to the opportunities offered by progress.

Notes

¹ Indeed, the global fertility rate in the early 1990s had fallen almost to the level projected under the *low by end of century* hypothesis prepared by CELADE at the end of the 1970s.

² It should be noted that this table tends to *underestimate* the decline in fertility desired, since it does not include the number of children conceived but subsequently aborted. If they were included, the effective fertility would be still higher, so that the decline needed in order to arrive at the number of children actually desired would be even greater than indicated in the table.

³ Purely by way of example of the orders of magnitude involved, it may be noted that if a net coefficient of investment of 12.5% (20% gross less 7.5% for depreciation) was required in the period 1950-1990 in order to generate productive jobs at a growth rate of 2.7% per year, then in order to achieve a rate of job generation in the 1990s 11.2% lower (that is to say, 2.4% per year), net investment which is likewise 11.2% lower, or approximately 1.5% less in terms of the GDP, will be needed.

⁴ It may be noted in this respect, for example, that the First Latin American Congress on the Social Doctrine of the Church, held in Santiago, Chile, in October 1991 and attended by theologians and experts from the entire Catholic world, concluded, in a document entitled "Commitment to the principles of

the social doctrine of the Church" that it was necessary to "promote the right of persons to establish a family, as well as conditions favouring mutual love between the spouses, responsible parenthood and education of the children". In other words, the Catholic Church *welcomes* responsible parenthood; what it does object to are *certain* methods of family planning which it terms "artificial".

⁵ This section is based on a detailed study made by the secretariat on this subject. See ECLAC/UNESCO, *Educación y conocimiento: eje de la transformación productiva con equidad*, op. cit.

⁶ For the purposes of the table, the "family educational climate" is defined as the average number of years of schooling of its members aged 15 years or more. This climate was subdivided in turn into three sections: "low" (less than six years of schooling), "medium" (between six and 9.9 years) and "high" (10 or more years of studies).

⁷ For a detailed analysis of the situation in a specific country (Uruguay), see ECLAC, ECLAC Office in Montevideo, *Qué aprenden y quiénes aprenden en las escuelas de Uruguay*, Montevideo 1990.

⁸ See ECLAC, *Organización familiar y equidad* (LC/R.1095; LC/DEM/R.152), Santiago, Chile, December 1991.

⁹ A fact which further confirms the importance of the degree of family organization is that the best educational attainments —once again, after taking account of the level of income and family educational level— are registered in extended families where not only both parents but at least one additional adult family member are present. This would also appear to indicate the importance of the stimuli and care received in the household, which are connected with the number of person-hours during which children have close daily contact with adults.

¹⁰ For a study which summarizes various case studies on this subject, see N. Dutcher, "The use of first and second language in primary education: selected case studies", World Bank Staff Working Paper No. 504, Washington, D.C., World Bank, 1982.

¹¹ See for example J. Lesourne, *Education et société. Les défis de l'an 2000*, Paris, Le Monde, Editions Découverte, 1988.

¹² George Psacharopoulos and Maureen Woodhall, *Education for Development: An Analysis of Investment Choices*, New York, Oxford University Press, World Bank, 1985.

¹³ Functional illiterates are usually considered to be persons with less than four years of formal schooling. For example, several studies linking educational attainment with productivity in agriculture have come to the conclusion that only after four to six years of basic schooling is it possible to observe a clear increase in the adoption and adaptation of new technologies and the proper use of inputs, for experimentation with and adaptation and application of the new technologies call for a good mastery of the four basic mathematical operations, plus the calculation of percentages and the application of the rule of three, and this knowledge is normally only acquired after a minimum of four to six years' schooling.

¹⁴ It would also be necessary to add to this the estimated cost of the labour training programmes proposed in chapter VI. Details of the elements taken into account in estimating the cost may be found in the ECLAC/UNESCO document entitled *Educación y conocimiento: eje de la transformación productiva con equidad*, already referred to.

Chapter IX

SOCIAL SECURITY AND TRANSFER POLICIES

1. Poverty, social equity and transfers

As noted above, during the economic crisis that affected Latin America and the Caribbean in the 1980s, the incidence of poverty increased considerably. The countries of the region have therefore placed the alleviation of poverty high on their political agenda. Moreover, a new type of poverty has sprung up in addition to the structural poverty that had been one of the dominant features of previous decades; it concerns persons who, having managed to escape from poverty, have fallen back into it as a result of the crisis or adjustment policies.

Four types of policies should be applied in the fight against both types of poverty: a) those that promote productive employment of poor families or improve the productivity of their activities so that they can earn better wages or income; b) those that improve the quality of the human resources of poor households or give them access to physical or natural capital; c) those that give them access to basic services such as housing and residential infrastructure; and d) those that provide a basic social security network and minimum earnings when, despite participating in economic activity, the poor do not generate sufficient temporary or regular income to escape from absolute poverty.

Moreover, as has already been noted in another ECLAC document,¹ poverty and the environmental situation are closely interrelated. Not only do the poor have little access to the social security system but they also live in a considerably deteriorated environment, and this

affects their standard of living. The predominant style of development in Latin America and the Caribbean has produced a high level of impoverishment in both urban and rural areas. The urban poor tend to settle in areas which are unsuitable for housing and often prone to natural disasters such as landslides and floods, and in the rural areas they live in ecosystems that are more fragile and vulnerable.

Social welfare, the improvement of standards of living and social equity are also systemic processes. Thus, although this chapter will only deal with social security programmes, a close relationship no doubt exists between the structure and cost of social security programmes and environmental quality and the provision of physical infrastructure for the target population. This is particularly important in the low-income sectors. For instance, the impact of inadequate housing conditions or basic infrastructure (drinking water, sanitation, etc.) on the incidence of gastrointestinal or respiratory diseases is well known. This has a direct effect on the health care requirements of that segment of the population, on the cost of health systems and on the volume of transfers. Therefore, even considerations of efficiency, coupled with the need for social equity, suggest the importance of ensuring that advances in social welfare systems should go hand in hand with simultaneous improvements in the environmental and residential conditions in which the most vulnerable segments of society live.

Previous chapters have dealt with other aspects of the fight against poverty. This chapter

will discuss social security policy and transfers, whose aim is to create a network that ensures minimal level of well-being in critical temporary or permanent situations. The task of alleviating poverty is a two-fold challenge. First, it is a challenge to the new production policies which are designed to introduce a style of economic growth capable of reducing poverty. Secondly, it is a challenge to the social policies that must provide a minimum level of welfare for all those who are impoverished as a result of being deprived, temporarily or permanently, of the benefits of economic growth especially, in the latter case, the handicapped and elderly.

Two types of programmes are considered from this perspective: those that are applied through social security institutions and whose aim is to ensure a minimum level of well-being during the different phases of life, and those designed to transfer earnings temporarily to deal with short-term crises (such as special employment programmes) or permanently for more chronic need situations (such as the replacement of minimum wages by minimum household income).

2. Social security programmes

There are considerable differences in the coverage and benefits of social security programmes between countries and within each country (see table IX-1). Indeed, in addition to the problem of low total coverage in most of the countries, there is also the problem of wide disparities in the amount of coverage among occupational groups, branches of economic activity and geographical units, which generally depends on how much pressure the group involved can exert. Thus, for instance, military personnel and public employees are usually the first to secure coverage, followed by schoolteachers, the police, bank employees and merchant navy personnel. The next largest group is employees and labourers, especially in the formal urban sector; the category of labourers is usually made up of farm, domestic and self-employed workers. Of course, the most

developed provinces, states or districts have much wider coverage; they are more industrialized and urbanized, and have more trade unions, the highest percentage of wage earners and higher per capita income (see table IX-2).

Likewise, there are considerable differences in both health and pension benefits within occupational groups, regions and age groups. Thus, for example, table IX-3 shows the substantial gaps that exist between pensions under the general retirement scheme (equal to 1) and the pensions of different occupational groups; the armed forces receive pensions which are 2.5 to 8 times higher than the general retirement scheme; bank employees, 3.4 to 5.8 times higher; policemen, 1.6 to 6.9 times higher; public employees, 1.2 to 3.8 times higher; rural labourers, 0.8 times higher; and domestic workers, 0.7 times higher. The poorer, more rural or remote the regions are, or the greater the concentration of indigenous population, the worse are the health care services they receive. As table IX-2 indicates, there are enormous differences between the areas with the best and worst health care. For example, the ratio of access to medical care is 63 to 1 in Peru, while the ratio of access to hospital beds is as much as 8 to 1 in Mexico.

Finally, there are differences depending on age groups. The bulk of social expenditure in the countries with older systems of social security is allocated to retirement pensions. In Brazil, for example, 31% of expenditure on social security benefits goes to 4.3% of the population (which has retired). On the other hand, the working-age population, which has a lower incidence of illness than the group composed of mothers and children, receives the bulk of spending on health care. For example, in Peru in 1985, 30% of the active population was covered by social security while only 1.4% of the population under age 14 was covered; in Colombia the figures were 15% and 3.6%, respectively. However, these two countries had some of the highest rates of infant mortality in the region.

Table IX-1
LATIN AMERICA AND THE CARIBBEAN: BASIC INDICATORS OF SOCIAL SECURITY SYSTEMS

Systems	COVERAGE			FINANCING		
	% population covered by health programme	% labour force covered by pension programme	Ratio of pensioners/contributors	% payroll paid for social security	Social security expenditure/GDP	Social security surplus as % GDP
<u>Advanced</u>						
Argentina	79	69	0.32	46	10	-2.3
Bahamas	85.3	85.9	-	8.8	0.7	1.4
Barbados	79.8	96.9	-	11.4	1.0	2.5
Brazil	96	96	0.18	26	5	-0.4
Chile	67	62	0.46	29	11	-5.7
Costa Rica	78	68	0.06	27	9	2.5
Cuba	100	93	0.21	10	9	-6.4
Jamaica	80.9	93.2	-	5.0	0.4	0.6
Uruguay	69	81	0.65	33	11	-4.3
<u>Intermediate</u>						
Bolivia	25	18	0.33	25	3	0.1
Colombia	12	22	0.05	20	4	-0.2
Ecuador	8	23	0.15	21	3	1.3
Mexico	53	42	0.08	18	3	0.1
Panama	50	46	0.12	21	7	2.4
Paraguay	18	14	0.07	20	2	-
Peru	17	37	0.09	21	3	-0.1
Venezuela	45	50	0.06	14	3	-
<u>Least developed</u>						
El Salvador	6	12	0.08	12	2	0.8
Guatemala	14	33	0.06	20	2	0.3
Haiti	1	2	n.a.	12	1	-
Honduras	7	13	0.02	14	3	0.2
Nicaragua	9	19	0.08	16	2	0.8
Dominican Republic	8	14	n.a.	14	2	-

Source: C. Mesa-Lago, "Aspectos económico-financieros de la seguridad social en América Latina y el Caribe. Tendencias, problemas y alternativas para el año 2000", document prepared for the Technical Department of the World Bank, 1990.

Table IX-2

LATIN AMERICA AND THE CARIBBEAN: GEOGRAPHIC DIFFERENCES IN THE COVERAGE
OF HEALTH SERVICES IN SELECTED COUNTRIES, 1979 TO 1986

Countries	% of population covered	Doctors per 10 000 inhabitants	Hospital beds per 1 000 inhabitants
Argentina (1980)			
Federal Capital	100.0 ^a	46.8	8.4
Formosa	6.0 ^a	8.1	4.3
Bolivia (1986)			
Oruro	32.8	n.d.	0.9
Pando	10.7	n.d.	0.2
Colombia (1984)			
Atlántico	24.7	n.d.	n.d.
Chocó	2.7	n.d.	n.d.
Costa Rica (1979)			
San José	33.9 ^b	12.4	5.7
Guanacaste	15.2 ^b	1.9	1.1
Cuba (1982)			
Havana	n.d.	41.2	11.2
Granma	n.d.	7.2	4.1
Chile (1980)			
Magallanes	95.0 ^c	5.3	4.8
La Araucanía	39.3 ^c	2.1	3.2
Ecuador (1979)			
Pichincha	19.8	14.4	2.8
Morona	2.6	4.0	1.6
Mexico (1980)			
Federal District	100.0	21.1 ^d	3.3 ^d
Oaxaca	17.2	2.4 ^d	0.4 ^d
Panama (1984)			
Panama City	75.2	10.7	5.2
Darién	10.8	4.0	2.7
Peru (1981)			
Lima	26.7	19.0	3.0
Apurímac	2.5	0.3	0.6
Uruguay (1984)			
Montevideo	68.7 ^d	35.4	3.8
Rivera	17.0 ^d	6.5	1.8

Source: C. Mesa-Lago, "Aspectos económico-financieros de la seguridad social en América Latina y el Caribe. Tendencias, problemas y alternativas para el año 2000", document prepared for the Technical Department of the World Bank, 1990.

^a 1960.

^b Does not include dependants.

^c Economically active population.

^d 1970.

^e Members of collective institutions, 1986.

Table IX-3
LATIN AMERICA AND THE CARIBBEAN: DIFFERENCES BETWEEN THE AVERAGE PENSIONS OF DIFFERENT
GROUPS OF INSURED PERSONS IN SELECTED COUNTRIES, 1980-1987 *

	Bolivia (1987)	Colombia (1982)	Costa Rica (1986)	Chile (1980)	Mexico (1980)	Uruguay (1982)
General	1.0	1.0	1.0	1.0 ^b	1.0 ^c	1.0 ^d
Armed forces		2.5		8.0	5.5 ^e	4.9
Police		1.6		6.9		4.1
Public employees	1.2	1.7		3.2	3.8	2.0
Teachers	1.3		3.4			2.0
Judiciary			5.8			
Bank employees		3.4		5.7		
Oil sector workers	2.2					3.8
Rural sector workers						0.8
Domestic/household employees						0.7

Source: C. Mesa-Lago, "Aspectos económico-financieros de la seguridad social en América Latina y el Caribe. Tendencias, problemas y alternativas para el año 2000", document prepared for the Technical Department of the World Bank, 1990, table 24.

* Ratio between the general system (1.0) and the other systems.

^b Social Insurance Service (SSS) (workers' fund), the largest in Chile at that time.

^c Mexican Social Security Institute (IMSS) (general private-sector fund), the largest in Mexico.

^d Office of Industry and Trade Sector Pensions (DIPALCO) (industry and commerce fund), the largest in Uruguay.

^e 1971 ratio.

In brief, the social security systems in Latin America and the Caribbean differ in terms of how long the pension programmes have been in force, the percentage of the population covered, the share financed from payroll taxes, the proportion of GDP and fiscal spending represented by expenditure on social insurance/social security, actuarial and financial soundness and the demographic structure of the participants. These characteristics can be used to classify countries according to the state of development of their social security systems (see table IX-1 and box IX-1).

Nine countries (Argentina, Bahamas, Barbados, Brazil, Costa Rica, Cuba, Chile, Jamaica and Uruguay), representing nearly half of the region's population, which have relatively advanced systems with fairly wide coverage (over two thirds of the population), costs close to 10% of GDP (the bulk —due to the age of the population— earmarked for pensions) and cash deficits.

Eight other countries (Bolivia, Colombia, Ecuador, Mexico, Panama, Paraguay, Peru and Venezuela), with over 40% of the regional population, have intermediate systems with coverage ranging from 12% to 50% of the population, costs of 3% or 4% of GDP (most of it earmarked for health) and with actuarial deficits.

The remaining countries, accounting for 10% of the region's population, have relatively new systems (established after the Second World War), little coverage and low costs (mainly for health care), and do not have serious financial problems.

Generally speaking, the more "advanced" the system, the more stratified it is, although after a certain point it tends to become more unified; the more risks it covers and the more benefits it offers, on more liberal terms; the more pay-as-you-go financing it uses and the less likely it is to have a partially or fully funded system. The more advanced the regime, the less saving and investment it generates, owing to the depletion of reserve and the increase in deficits, and the more distributive, neutral or progressive its impact, because of the comprehensiveness of

coverage and the incorporation of social welfare programmes.

a) *The lack of equity in current systems*

The foregoing confirms the growing consensus that the main shortcoming of the region's social security systems is their lack of equity. Recent evaluations of these systems in Latin America² conclude that such systems basically serve the interests of a small fraction of the population made up of workers in the modern sectors of the economy, but overlook the needs of the poorest sectors; that the maintenance of multiple systems of benefits heightens inequalities and makes the systems more inefficient; and that the part of the health system under the administration of social security encourages dependence on expensive drugs and high technology. To introduce greater equity into existing social security systems, coverage should be expanded to the whole population, especially to those who are not now covered or who receive very few benefits, and all should receive better and more equitable benefits.³

In order to more clearly explain the impact on poverty and social equity of current transfer programmes, three questions will have to be answered. Who benefits from transfers? Who needs transfers and should benefit from them? Who finances such transfers?

i) *Who benefits from them?* In most countries, pension benefits are directly related to the contributions made during the last few years of work. They therefore tend to favour those who received and declared higher incomes during their last years of active employment and underdeclared their incomes in the initial years. Since normally no one can declare that he earns less than the minimum wage, prospects of underdeclaring income during their working lives and later declaring higher effective income at the end are much better for persons with higher incomes. As a result, pensions disproportionately benefit sectors with higher

Box IX-1

TYPOLOGY OF LEVELS OF DEVELOPMENT OF SOCIAL SECURITY SYSTEMS

A comparative study funded by ECLAC classified the countries of the region into three groups according to the level of development of their social security systems.

The advanced group, which includes five pioneer countries in the area of social security —Argentina, Brazil, Chile, Cuba and Uruguay— as well as four countries with more recent systems but with high coverage —Bahamas, Barbados, Costa Rica and Jamaica— generally has the following characteristics: 1) the first pension programmes were launched in the 1920s and 1930s; 2) more than 60% of the total population and the economically active population are covered; 3) the total percentage of payroll contribution (the sum of total contributions paid by the insured, employer and the State) is equal to or over 26%, social security expenditure fluctuates between 9% and 11% of GDP and averages 33% of fiscal spending; 4) between 44% and 79% of such expenditure is on pensions, owing to the age and maturity of the programme and the high life expectancy; 5) the ratio of liabilities (pensioners) to assets (active workers) is very high, sometimes as much as 0.6, which means that each pensioner is financed by fewer than two contributing insured persons; this is because of the slow growth rate and aging of the population and the impossibility of incorporating new groups of insured persons (because coverage is already universal) and the maturity of the pension programme; and 6) the system is facing a serious actuarial and financial imbalance which will probably worsen in future and will require ever-increasing transfers from the Treasury. An urgent, comprehensive reform therefore needs to be carried out.

The intermediate group of countries, comprised of Bolivia, Colombia, Ecuador, Mexico, Panama, Paraguay, Peru and Venezuela has the following characteristics: 1) the pension programmes were launched between the 1930s and 1940s; 2) coverage of the population fluctuates between 12% and 53%; 3) the total percentage of payroll contributions fluctuates between 18% and 25%, and social security expenditure normally varies between 3% and 4% of GDP and between 14% and 23% of fiscal spending; 4) the bulk of such expenditure is devoted to health care (because these are countries at a late stage of demographic transition, and they have a high dependency ratio), while only between 20% and 40% is spent on pensions (because of the relatively young age of this programme —i.e., less maturity— and lower life expectancy than in the advanced group); and 5) the liabilities/assets ratio fluctuates between 0.05 and 0.15 (for the reasons already explained above, plus a high population growth rate and the gradual incorporation into the system of groups of non-insured persons); and 6) the system has an actuarial imbalance and is heading towards a financial deficit in the medium or short term.

The third group, comprising El Salvador, Guatemala, Haiti, Honduras and the Dominican Republic, has the following characteristics: 1) the pension programmes were established in the 1950s and 1960s; 2) less than 10% of the total population and 19% of the economically active population is covered, and such coverage is concentrated in the capital and largest cities; 3) the total percentage of payroll contributions is low, between 12% and 16%, social security expenditure fluctuates between 1% and 2% of GDP and does not top 18% of fiscal spending; 4) about 80% of fiscal spending is devoted to sickness benefits and less than 20% to pensions (because the programme is young and life expectancy is very low); 5) the liabilities/assets ratio is very low, between 0.02 and 0.08, for the same reasons as mentioned above, and the very high population growth rate and the potential for extending coverage; and 6) although the system does not face any financial deficit, at least in the short and medium term, it might have an actuarial imbalance.

Source: See C. Mesa-Lago, "Aspectos económico-financieros de la seguridad social en América Latina y el Caribe. Tendencias, problemas y alternativas para el año 2000", document prepared for the Technical Department of the World Bank, 1990.

incomes both within the system and in comparison with the population as a whole.

Health benefits, on the other hand, are provided more on the basis of the medical needs of the contributors than for their contributions to the system; thus, theoretically, these transfers would contribute to equity within the system. However, in practice, given the partial coverage of the system and the fact that relatively richer groups have privileged access to it, a high proportion of the total government expenditure on health does not go to those who need it most but to workers in the formal sector and the middle classes. The poor, particularly those in rural areas, do not have access to these benefits.

On the whole, studies note that social security has a negative effect on income distribution since it tends to reproduce the current degree of inequality. This is the result of limited coverage and the coexistence of various subsystems with different benefits. At the top of the pyramid of beneficiaries are those who enjoy the best services, either because they pay for them privately or belong to some State or private "corporation" which has had enough power or influence to obtain them from the State. The middle range of the pyramid is occupied by those with intermediate incomes and moderate influence who receive appropriate benefits. Finally, at the base of the pyramid are those who have insufficient income or influence and have access, at best, only to small pensions and the services offered by social welfare.

ii) *Who should benefit?* If the social security system were equitable, its benefits would be distributed according to the needs of people and families and not on the basis of their income or influence. However, studies show that those who need such systems the most, i.e., the poor, especially those in the rural areas and the informal urban sector, the handicapped, the chronically ill, children and low-income elderly people, are the ones who receive the least coverage and benefit the least from them. Nevertheless, the system tends to gear its services to the elderly who may be less vulnerable, including those who can finance

their own retirement and relatively healthy, active adults. In fact, under current schemes, the structure of benefits is determined almost proportionately by income distribution and political influence, excluding precisely those who are meant to benefit from the schemes.

iii) *Who finances the system?* Social security is usually financed through payroll taxes, which theoretically represent a cost for the firm and the worker. However, there are three reasons why continued expansion of coverage based on payroll taxes could turn out to be inequitable. First, some argue that in view of the way prices are determined in most countries of the region, these costs could be passed on to consumers through price rises, and that in the long run, those who consume goods and services produced by the modern sectors of the economy are the ones who pay these costs. Thus, the systems which do not have universal coverage transfer resources from the consumer sectors, which are often represented by the poorest sectors, to workers of the modern sectors of the economy.

Secondly, others hold that in those countries where coverage has been expanded, it cannot keep on expanding by raising contributions, since wage earners already bear a heavy tax burden. However, the system's finances could be better managed by checking the erosion and decline of its resources, recovering the debt owed by the State and by firms that are in arrears with the system, and improving the policy for investment of accumulated funds.

Thirdly, it is argued that this form of financing is a sort of tax on the hiring of labour and that it might therefore discourage employment. Indeed, in so far as the social security benefits for workers are relatively independent of their contributions—as usually occurs with pensions and health care⁴—a difference is created between the cost of labour to the enterprise and the value that wages plus social security benefits have for the worker. This difference may fluctuate between 10% and 20% of wages, and hence firms will tend to substitute

labour for capital; it will also artificially raise the cost of production and labour-intensive activities. Consequently, for as long as social security contributions are made on the basis of the payroll (and not, for example, on the basis of the firm's value added) they will not be equitable because of their negative impact on employment and therefore on the wage bill.

b) *Expansion and quality of coverage*

As long as social security systems favoured a minority, it was possible for both the benefits and risks covered to be expanded in a relatively generous manner, since such minority groups were a small fraction of the population and, initially, the ratio of active workers (assets) to pensioners (liabilities) was low. Thus, for example, the retirement age could be frozen or even lowered despite the fact that life expectancy was increasing; people were allowed to retire on the basis of seniority, not only because of their age, and women were allowed to retire younger (without being made to pay higher contributions); the base salary for retirement purposes was calculated on the basis of the wage earned during a short period corresponding to the last few years of work, not on the basis of the wage earned during most of the contributor's working life; sickness and maternity benefits equivalent to substantial proportions of the base wage were paid without stipulating long periods of prior contributions (this encouraged subscribers to feign illness or to begin contributing just before a medical treatment or hospital stay and stop contributing immediately thereafter).

Such privileged benefits, financed only in part by the insured, not only had a regressive impact on income distribution, but also contributed to the escalation of costs per insured; this either caused a financial and actuarial imbalance and a deterioration in the value of pensions and the quality of health care by attempting to make them universal, or simply prevented them from expanding. Indeed, this very generosity makes it difficult to expand

basic benefits horizontally or universally (for example by providing minimum pensions and primary health care) to the majority of the population since what is financially feasible for an influential minority of subscribers —although influence is unjustified from the standpoint of equity— becomes unworkable when the system is universalized.

The foregoing conclusions indicate, on the one hand, that if the stated aim is to bring about equity and particularly to favour the poorest groups, then the number of people and risks covered by social security must be increased. On the other hand, the cost of extending social security coverage to the entire population of Latin America and the Caribbean under the current systems does not seem, in many countries, to be economically feasible.

On the basis of a simple extrapolation (and therefore only an indication of the orders of magnitude), a recent study shows how social security expenditure (exclusive of social welfare), expressed as a percentage of GDP, would increase in 22 countries of the region (see table IX-1). The estimates are made on the assumption that the entire population is covered by the per capita cost of the current system. Three broad conclusions may be drawn:

i) Six countries could achieve universal coverage with a relatively small added proportion of GDP (less than three percentage points); Jamaica, Bahamas, Barbados, Venezuela, Mexico and Brazil. The three English-speaking Caribbean countries on this list have lower extrapolated percentages, since the expenditure of the national health system is not included, and their pension programme is based on a young population structure; had their health expenditure been included (to make it more comparable with the health spending of Latin American countries, all of which have illness-maternity social insurance programmes), the extrapolated percentages of these three Caribbean countries would have been the same as Brazil's. On the other hand, Mexico and Venezuela have low extrapolated percentages because the calculations were based on the years

Box IX-2

THE EXPANSION OF COVERAGE TO RURAL SECTORS

In Mexico, the Mexican Social Security Institute (IMSS) began to extend its coverage to the rural areas in 1954; the first major boost came in 1973, however, with the creation of the Social Solidarity programme, 60% funded by the Federal Government and 40% by IMSS. A programme for the general coordination of the National Plan on Depressed Areas and Marginalized Groups (COPLAMAR) was established in 1976, and in 1979 it signed an agreement with IMSS to extend the coverage of primary health care to marginal rural areas. By 1985, 3 246 rural clinics and 65 hospitals had been built by IMSS-COPLAMAR. In 1985, maximum IMSS-COPLAMAR coverage was attained of an estimated population of 13.7 million, or 85% of the potential target population; however, in 1986, IMSS-COPLAMAR coverage dropped to only 9.8 million, the rest being covered by the State, as a result of decentralization. The covered population receives the following benefits: maternal-child care, medicines, diagnosis and monitoring of chronic diseases, family planning, preventive health care and health education. These services are delivered at the primary level by clinics and at the secondary level by hospitals, both of which are run by IMSS-COPLAMAR; at the tertiary level, Ministry of Health hospitals are used (the tertiary population does not have access to IMSS hospitals). The programme is run by "*pasantes*" (newly graduated doctors who offer a year of service) and young, bilingual assistants from the community itself. In 1986, 90.6% of the programme's budget was financed by the Federal Government and 9.4% by IMSS, although IMSS also absorbed indirect administrative costs estimated at about half the total real costs. Although the insured do not have to pay cash contributions, they do have to contribute their collective labour in the construction of facilities, prevention and sanitation work, etc. The per capita cost of IMSS-COPLAMAR services was less than half of the corresponding costs of the services of the Ministry of Health, which in turn were much lower than the costs of IMSS.

In Brazil, the Sistema Nacional de Previdência e Assistência Social (SINPAS) extended coverage to the rural areas in the 1970s through two programmes: one providing of social insurance, the Fundo de Assistência ao Trabalhador Rural (FUNRURAL) and the other dependent on the Ministry of Health and the health services of the states (Programa de Inter-relacionamento de Ações de Saúde e Saneamento, PIASS). FUNRURAL began operating, independently, in 1971 providing pensions and health care to the rural populations and towns of less than 20 000 inhabitants; the network of facilities (through agreements with trade unions, States, municipalities and private bodies) comprises health posts and centres, polyclinics and hospitals; in 1977 FUNRURAL became part of the social security system. The programme is financed through three taxes: i) 2.5% on rural production, collected by the producer and paid by the buyer (corresponding to 35% of total income in 1980); ii) 2.4% on the payroll of urban enterprises (63% of revenue); and iii) 0.036% paid by rural employers, based on production and the value of uncultivated agricultural property (2% of revenue). Since 1978, the programme has recorded a deficit which amounted to 11% of revenue in 1981, as a result of tax evasion estimated at between a third and half of the potential taxes that could have been collected. The Social Investment Fund (FINSOCIAL) was established in 1982 with a contribution of 0.5% of the earnings of all enterprises of the country to help finance the programme.

In Ecuador, the Rural Social Insurance scheme (SSC), which is part of the Ecuadorian Social Security Institute (IESS), was founded in 1968 and gathered momentum in 1973 and 1981. It covers farmers organized into cooperatives and rural associations; in 1983, its coverage was 2.4% of the total population and 9% of the rural population. It provides low-cost primary health care and its services are based on rural posts set up on community land, with a basic structure provided by IESS and labour furnished by the community. Maternal and dental care are provided by an itinerant doctor, while auxiliary staff provide prenatal care, health education and immunization. Patients who cannot be attended at the rural health post have to be transported to more sophisticated IESS facilities. The programme is financed by a 1% payroll contribution from the IESS insured (divided equally between the insured, the employer and the State) plus the equivalent of 1% of the minimum wage paid by the participating farmer.

Source: See C. Mesa-Lago, "Aspectos económico-financieros de la seguridad social en América Latina y el Caribe. Tendencias, problemas y alternativas para el año 2000", document prepared for the Technical Department of the World Bank, 1990.

of the oil boom and, consequently, on a high GDP which reduces the relative cost of coverage; in the case of Venezuela, another factor that reduces expenditure is the fact that its pension programme is new. Lastly, Mexico and Brazil have significantly expanded coverage of the rural sector with relatively low-cost programmes (see box IX-2); this explains the low extrapolated percentage for these countries.

ii) Paraguay, Cuba and Costa Rica have higher extrapolated percentages than the above-mentioned countries. However, Cuba and Costa Rica have achieved virtually total coverage of their respective populations, and thus the required additional increment is small. Another group of countries which is already approaching universal coverage but with even higher extrapolated percentages is composed of Uruguay, Argentina and Chile. However, these three countries, like Costa Rica, already have social insurance (or public health programmes) that protect the indigent and the extrapolation therefore exaggerates the cost of universalization.

iii) In some of the least-developed Latin American countries, such as Ecuador, Nicaragua, El Salvador, Colombia and Peru, the increase in GDP required would be economically unmanageable (over 10 percentage points of GDP). The universalization of coverage in these countries cannot be achieved at current levels of benefits and administrative costs, since the financial burden would be very high.

c) *Social insurance and social welfare*

In order to carry out reforms of these systems based on equity and to overcome the cost dilemma, the criteria used to organize transfers through social security institutions should be redefined to reflect the nature of the risk. On the one hand, the systems may offer a *shared insurance*—between the contributors and the system—against risks of fluctuations in the contributor's income during his lifetime on the basis of actuarially-determined payments and benefits. Examples of such payments and

benefits are old age, disability and death pensions; medical and hospital care and cash payments for occupational hazards; medical and hospital care and cash payments for common illnesses and maternity; and unemployment benefits.

On the other hand, the systems should offer *minimal income security* to all those persons, especially the poor, who otherwise might not be able to take out insurance against certain basic risks. Such benefits should include, for instance, family allowances, social welfare (such as pensions that do not require contributions or are granted to indigents who do not meet the requirements for social security benefits), and national health schemes or public health care programmes.

The main problem, stemming from the unequal distribution of income in the countries of the region, is that many people do not earn enough to be able to make provision against possible risks throughout their lives. In so far as governments seek to provide universal insurance coverage against basic risks as an ethical and social norm, a distinction should be made between the benefits that satisfy the basic needs of the population and require a substantial government contribution to finance them, and those that insure a smaller proportion of the population against certain risks under programmes that are not always comprehensive, and whose beneficiaries can easily support themselves without any major State contribution.

The great majority of Latin American countries generally follow the traditional model based on the principle of provision (social insurance), which in turn is based on the tri-partite system (old age, disability and death pensions; professional medical and hospital care; and community medical and hospital and maternity care) that was introduced in Germany at the end of the last century. However, the uneven distribution of income in the countries of the region has cast some doubts on its applicability, especially where, governments have sought to expand coverage of risks and the population with a view to more equity, since

large sectors of the population are unable to contribute.

Although the more developed countries have attained universal coverage of the population (or are close to doing so), they have achieved this at a very high economic cost and, in many cases, without either managing to correct inequalities with respect to coverage, financing and benefits or improving administrative efficiency. Moreover, the existing systems are facing serious actuarial and financial imbalances in these countries, and the State is no longer able to subsidize their deficits, particularly in view of the long and severe economic crisis.

On the other hand, the Latin American countries of the intermediate group have been unable to solve their problem of coverage. Although they did not have serious financial problems until the 1980s, less than half of their population is covered. A few of them (Panama, Mexico and Venezuela) rapidly expanded their coverage in the 1970s to parts of the rural sector or partially integrated their health services; in Mexico and Venezuela this was made possible by the oil boom. The crisis of the 1980s has paralysed or reduced the pace of these advances, and some of the countries have begun to experience the imbalances peculiar to the pioneer countries in this field.

The least-developed countries of the region had relatively solvent systems during the 1980s, although they covered less than a quarter of their population. The expansion of coverage is limited by structural barriers and the economic crisis, which has led to financial deterioration in some countries.

In order to deal with the apparent dilemma between the need to universalize coverage and the exorbitant costs this would entail, two of the pioneer countries in the establishment of social security systems, Cuba and Chile, have carried out radical reforms based on opposing principles. In line with the principle of equity and satisfaction of the population's basic needs, the entire system was nationalized in Cuba, in the 1960s. Thus, universal coverage was attained, the system was unified and most

inequalities were eliminated (the only exceptions are the armed forces, which have a privileged system, and private farmers, who are excluded from cash benefits). However, the system is facing growing deficits which are covered by the State, and this has eroded the real value of pensions.

In Chile, on the other hand, in the 1980s the principle of provision was used to gradually privatize social insurance, and this has made it possible to move towards universal coverage and uniformity (also with the exception of the armed forces) and to establish a new, solvent pension system. This has been achieved at the cost of a huge jump in the deficit of the old system and of a government subsidy to cover the deficit and to provide minimum pensions.

d) *Proposed reforms*

On the basis of these experiences and in line with the principles of equity and financial solvency, it is proposed, *firstly*, that social security should be reformed on the basis of a mixed system that combines both principles: a universal system of basic benefits financed from general resources and based on social solidarity; and a system of public and/or private benefits with complete equivalency between what is paid and what is received, based on private provision. Such a structure would make for considerable progress towards equity, would be politically more viable and would provide better benefits to those who put in a personal effort.

Secondly, coverage of groups not already covered should be extended selectively, both in relation to the groups and to the types of services covered. Indeed, certain groups (e.g., wage earning farm labourers) have greater needs than others (e.g., some self-employed workers). Services provided in certain areas, such as health, are generally given greater priority over others, such as extension of pensions; and within the area of health itself, primary as well as maternal and child care are crucial. In fact, various countries (Mexico, Brazil and Ecuador—see box IX-2) have expanded social security

coverage to formally non-covered sectors (peasants in rural areas) and have demonstrated that the additional cost of such expansion programmes could be reduced substantially if benefits are focused on primary and preventive care and more efficient services are provided. In any case, such an expansion requires considerable State subsidies, since the population that has traditionally not been covered by social security systems usually earns much less than the covered population, and it is much more difficult to identify and incorporate it into the system and to supervised the payment of its contributions.

Thirdly, in order to reduce the cost of benefits and increase their equity, the following key changes are recommended: a) consolidating the different (public) systems of retirement to reduce costs (by economies of scale) and attenuate differences and inequalities; b) eliminating seniority pensions and retaining only old-age pensions (or, in special cases—including gender differentials—allowing early retirement provided higher contributions are made); c) raising and adjusting the retirement age in line with the higher life expectancy after age 65; d) linking pensions to contributions made throughout the insured person's working life and not only to the contributions of the last few years; e) standardizing the conditions of eligibility and the calculation of benefits, particularly pensions; f) reducing the percentage of the wage that is paid as sickness benefit and establishing a minimum waiting period to avoid feigned illnesses; g) eliminating sickness benefits that are too generous for the level of development, such as travel and treatment abroad; and h) giving priority to primary health care over curative medicine.

Fourthly, in order to minimize disincentives to the hiring of manpower, the employer's share of the contribution should be paid according to the firm's value added and not as a proportion of the total value of remunerations. Although this does not affect the financing provided by the firm, it does correct the disincentive to hiring and redistributes the contribution from labour-intensive to capital-intensive enterprises.

3. Transfer programmes

a) *Emergency employment programmes*

In view of the importance of employment as the main source of income for the great majority of the population and the decline in productive employment in the wake of the recession of the 1980s, various countries adopted special emergency employment programmes in that decade to provide some protection for the earnings of the most severely affected groups of poor people. This was, in fact, a way of transferring resources to those who were considered poor.⁵

i) *Poverty is highly correlated with unemployment and the level of real wages/productivity of the economically active members of the household.* When per capita household incomes are compared over time, four indicators are usually used: i) the income per employed household member, to express the ratio of wages to productivity; ii) the number of employed household members as a proportion of those who wish to work, to show the impact of unemployment on household members; iii) the number of household members who wish to work as a proportion of those of working-age, to represent the desire to participate in the labour force; and iv) the number of working-age persons as a proportion of dependent persons in the household, to indicate the dependency ratio of the household.

The crisis of the 1980s changed the importance of these factors in determining the impact of poverty on households; poverty increased significantly in those households whose earnings were especially affected by declines in the earnings of their employed members (real wages/productivity effect). Likewise, the incidence of indigence rose in those households affected by increases in the number of unemployed (unemployment effect). Total poverty expanded considerably as a result of declines in per capita real wages and the

substantial rise in indigence stemmed from a higher unemployment rate.⁶

This situation has led to the need to recommend anticyclical transfers to combat unemployment and the fall in real wages as a policy to prevent cyclical increases in poverty. In so far as unemployment and wage fluctuations are considered temporary and subject to economic fluctuations, such transfers should also be temporary and anticyclical, depending on the levels of unemployment and real wages of the poorest households.

ii) *In order to enhance social equity, emergency jobs should be productive but should not be substitutes for other sources of employment.* Emergency programmes prepared with such objectives in mind include both job creation through projects financed with public resources and the subsidizing of labour recruitment by private firms through various procedures.

Although experiments have been conducted on the subsidizing of labour recruitment by the private sector—which would incorporate the unemployed into the real labour market—the subsidy programmes have not thrived. In a recession, firms are much more sensitive to demand than to their labour costs. Therefore, subsidies do not significantly increase the level of employment. They do mean, on the other hand, that those firms which were in any case increasing their workforce (perhaps because their demand was rising) are now receiving subsidies in addition.

As a result, the most widely applied and most successful emergency programmes are those financed and implemented directly by the State. They differ from normal public works projects in that the main condition is not that they should be economically feasible projects but rather that they should be labour-intensive, and labour typically accounts for 80% or more of their costs. They are therefore attractive from the political and social standpoint but not from the economic one. They are particularly useful in crisis situations, since they are a clear manifestation

of the determination of governments to tackle the problems of unemployment and low incomes; they have a faster impact than market-based measures and make it possible to focus attention on the groups most affected by the crisis.

Since the basic objective of these programmes is job creation and the maintenance of a minimum income for the groups most affected by the crisis, they are targeted to the poorest sectors (see box IX-3). In fact, although they are well designed, they normally attract only the poorest groups because of the low level of wages they offer (typically lower than the minimum wage); thus, they have the advantage that, in a way, the poor themselves take the decision to have recourse to them. On the other hand, since these programmes are abnormally labour-intensive and usually turn out to make little profit in the private sector, they do not usually have an impact on other sources of job creation.

All the foregoing requires a number of both macro and microeconomic constraints for its design. At the macroeconomic level, government expenditure should be autonomous and separate from aggregate demand in order to constitute an anticyclical rather than procyclical instrument with respect to employment trends, and the programme should not be inflationary, i.e., it should be funded and should use surplus inputs which do not put pressure on the balance of payments. Consequently, the programmes should use abundant labour, should not generate excessive demand that would artificially raise wages, and should make intensive use of national inputs. At the microeconomic level, payment for the work done should not artificially increase wages in private enterprises where there are employment alternatives for this labour.

A review of the experiences of such programmes in Latin America by PREALC has shown (see box IX-3) that over short periods of time the programmes managed to create jobs for a considerable number of persons and that within those same periods the programmes benefited the poorest social groups. The programmes also fostered some involvement on the part of the

Box IX-3

ESTIMATE OF THE IMPACT OF EMERGENCY EMPLOYMENT PROGRAMMES ON POVERTY

Estimates made by the Regional Employment Programme for Latin America and the Caribbean (PREALC) indicate that emergency programmes have met the objective of benefiting the poorest social groups. The figures available on the Temporary Income Support Programme (PAIT) of Peru, the Minimum Employment Programme (PEM) and Employment Programme for Heads of Household (POJH) of Chile and the Emergency Social Welfare Fund (FSE) of Bolivia show that a very high proportion of workers under these programmes come from indigent families and that the rest are from poor households (see table below). Although this type of information is not available for FSE, it can be assumed from the data on the characteristics of its housing units (30% do not have electricity, 78% lack indoor sanitation facilities, 84% do not have a sewage system and 46% do not have access to the drinking water network) that a great majority of participants in the Fund are also from poor households. A look at the impact of wages on household income confirms the foregoing. Wages represent no less than 50% of the total earnings of two thirds of the households of participants in PAIT and half of the households of the participants in PEM and POJH. In both countries, this impact could have been higher still in cases where more than one family member participates in the programme, and this situation has been relatively frequent, although no actual figures in that respect are available. Wages are the only source of income of 50% of the households of participants in FSE and make up no less than half of the earnings of 74% of these households.

Likewise notwithstanding the importance for the household economy of wages earned through participation in employment programmes, which in some cases were the only means by which the family could survive, these wages have been frequently insufficient even in terms of essential needs: they represented barely a quarter of the costs of the basic household basket in the PEM of Chile and half in the cases of PAIT of Peru and POJH of Chile.

HOUSEHOLD INCOME OF WORKERS UNDER SPECIAL EMPLOYMENT PROGRAMMES

	PAIT ^a	PEM ^b	POJH ^b	FSE ^c
	(Peru)	(Chile)	(Chile)	(Bolivia)
A) Household income of workers in emergency programmes ^d				
% Indigents	65.0	80.0	70.0	n.d.
% Poor	35.0	20.0	30.0	n.d.
B) Impact of wages under the programme on total household income				
Sole source of household income	21.5	24.0	31.6	51.0
Up to 50% of household income	65.5	48.3	54.0	74.0

Source: José Wurgaft (ed.), *Empleos de emergencia*, Santiago, Chile, Regional Employment Programme for Latin America and the Caribbean (PREALC), 1988.

^a December 1985.

^b August 1983.

^c April 1988.

^d Indigent families are those whose income does not cover the costs of a basic food basket and poor households are those whose income is up to double the income of indigent households.

community and social interaction among its members on the job and during consultations on the planning, and developed projects that are useful to the community, even though not enough so to be justified privately or socially in normal periods. However, earnings were insufficient to meet the needs of households. In brief, the programmes were a valid instrument in terms of their capacity to create a large number of jobs, distribute income to the poorest groups, increase their social involvement and attain economically and socially productive results.

The same studies, however, also detected problems such as diversion to sectors other than the target groups, especially for political ends; technical shortcomings in the projects due to the lack of studies; low productivity and inefficiency as a result of the lack of complementary inputs, the poor training of workers or the quality of their work; the fact that the crisis outlasted the programmes; the total lack of social security and other legislative guarantees for participants; and excessive centralization in the administration of programmes.

iii) *To prevent the programmes from acting as a substitute for other forms of job creation, their financing must have special characteristics.* The previous evaluations stress the need to distinguish between two types of job-creation programmes: temporary programmes to compensate for the low levels of employment and wages of poor households during periods of crisis; and more permanent programmes, related to public investment schemes with clearly productive goals. Their financing poses a dilemma that calls for the defining of priorities with respect to the content of investments. If it is decided to create jobs immediately—even with the constraints on the programmes with respect to permanence and productivity, but with positive social results—a schedule of public investments would have to be set up, which involves postponing more productive investments which would have a weaker effect on job creation in the short term.

Financing through Government investment resources replaces a source of funding which creates more permanent jobs by another source of creating more temporary jobs. To prevent this situation, some countries of the region have financed the costs of such programmes from extraordinary external resources which, because they do not deprive already programmed public or private activities of resources, have additional positive impacts on jobs.

In any case, once the decision has been taken to distribute income, there is a need to determine whether it is preferable to create low-productivity jobs in order to minimize the use of other capital inputs and goods, or to provide training by paying "scholarships" or study subsidies for those registered in the programme. Indeed, training is very labour-intensive, does not require too many additional inputs and could be a more beneficial way of distributing a minimum of income to the unemployed.

If it is decided to distribute income by creating direct emergency jobs through small public works programmes, the following recommendations should be considered in order to increase job productivity and enhance the benefits arising out of the programmes as much as possible: project portfolios prepared before critical unemployment situations occurred, not only in small public works programmes but also in the area of social services (such as increasing the number of assistants and auxiliary staff in pre-school education and hospital services, respectively) should be available; the personal profiles of participants should be taken into account in designing the programmes; permanent institution-based schemes should be available which could serve as the cornerstone of the programmes and allows for the contents of the programmes and their financial and administrative aspects to be quickly tailored to each emergency; an effort should be made to organize the beneficiaries through small enterprises linked to the programme, both for the implementation of projects and for the manufacture of inputs and tools; existing rules need to be made more flexible in order to have

enough resources to purchase materials and inputs and to hire skilled workers to improve productivity through more overall expenditure on wages; an attempt should be made to interest workers in the job to be done so that they will be more committed and efficient; in view of the emergency, enough wages, including social security benefits, should be paid so that their impact on household income will be felt; a substantial amount of training should be provided to some of the participating workers, especially the young ones who are entering the workforce for the first time, and finally, priority should be given to those projects which help create permanent jobs, such as irrigation, land improvement and training projects and the establishment of small and micro enterprises.

To sum up, the dilemma stems from trying to use a single instrument to achieve two different objectives. One objective is to distribute income through job creation; the other is to implement social projects that fulfil the dual function of supporting social infrastructure (basic services, construction of health and educational facilities), economic infrastructure (irrigation, access roads, etc.) or productive projects. Initially, special employment programmes basically focused on the first objective, with the aim of transferring incomes in a more dignified manner than paying unemployment subsidies. As a result of the prolongation of the crisis and the desire to include economic and social productivity in these programmes, they are now not much different from other job-creation alternatives. The crisis situation was used to obtain additional resources for adjustment programmes or to redirect existing programmes towards investment. However, as this process has been making it more expensive to create jobs, it neutralizes the achievement of the first objective.⁷

b) *Social investment funds*

A considerable number of social investment funds have been and are being created as a result of experiences gathered from

emergency employment programmes.⁸ The emphasis of the new funds has shifted from the creation of emergency jobs during the crisis and adjustment to greater concern for longer-term social investment projects basically in the area of health, education, nutrition and food programmes, among others.

The aim of social investment funds is to create more permanent jobs in activities of greater social utility. They attract resources and promote projects, complement and contribute to the smooth operation of the government machinery, and instead of being bodies which compete with or act as substitute for ministerial social structures, they coordinate their activities with other government programmes. However, being generally autonomous and having ties with the Office of the President, they enjoy considerable political support, which helps to speed up decisions and cut through red tape. Moreover, since they usually have high-level technical teams whose members are paid salaries that are competitive with those of the private sector, their management approach can be more business like than bureaucratic.

From the outset the funds usually incorporate public institutions especially municipalities, local communities and non-governmental organizations on the one hand, and international donor and funding agencies on the other. Since NGOs and State bodies often do not maintain close ties, the funds can help considerably towards bringing them closer together, which could result in the identification of a larger number of projects and more efficient implementation. Another feature of the funds is that they work through bids—with NGOs, private contracting firms or local communities—which frees them from operational tasks and allows them to focus on the main work of collecting and allocating resources and evaluating the use of such resources.

Despite their greater flexibility, the funds also have problems in reaching the poorest groups of the population who have slimmer prospects of exerting pressure because they are not well organized, are usually less capable of

preparing projects and are often in remote areas. To overcome these problems, the funds should contribute, together with their counterparts, to creating mechanisms that strengthen the community's ability to formulate projects of appropriate technical design. To do this, they should earmark resources for promoting the training of human resources in municipalities, development corporations and local communities.

c) *Transfers to combat chronic poverty: minimum household income*

One of the instruments traditionally used to raise income, although not production, is the minimum wage. The minimum wage has also been used for stabilization purposes, and for that reason it has grown less over the past few years than average wages and productivity in many countries of the region (see table IX-4). Its use as an instrument for bringing about equity has serious limitations that the "minimum household income" policy tries to correct.

One of these limitations is the fact that it covers only wage earners and usually only those living in urban areas, and hence some of the poorest income earners remain outside its scope. Such is the case of self-employed workers, who make up nearly one third of the region's labour force. Nevertheless, as virtually any distributive instrument has the same if not greater drawbacks, the raising of minimum wages is usually used to augment income (although in the 1980s it was used under anti-inflationary programmes to curb wage increases).

However, the minimum wage has two other limitations. First, it is not clearly focused, since it is basically meant more for unskilled workers or workers with little working experience (youth and women especially) than for heads of households. Also, its impact is regressive in that it has a higher relative cost for the less productive and less profitable, more labour-intensive enterprises which are usually the smallest. Secondly, if it goes above the

break-even wage, it will tend (except in recessions as a result of insufficient aggregate demand or in monopsony markets) to raise the income of wage earners but at the expense of jobs. This is because the firms see it as a tax which could be avoided simply by hiring fewer people.

Moreover, the raising of the minimum wage could be a regressive measure for the wage earners themselves, since when the demand for jobs is relatively inelastic (which occurs when labour is more skilled), raising the minimum wage will increase the wage bill; but when demand is more elastic (with less skilled labour) the wage bill falls. Thus, the wage bill is redistributed in favour of the most skilled workers.

i) *Minimum household income policies are designed to reap the benefits of minimum wages and limit their shortcomings.* With a view to overcoming the limitations of minimum wages, minimum household income policies try to improve the incomes of workers while leaving jobs intact and to focus benefits on the poorest households. In order to eliminate the disincentive to hiring introduced by the minimum wage, firms should absorb only the cost of the old minimum wage while the State subsidizes the difference between the minimum wage defrayed by the firm and the minimum household income to be paid to the worker. Thus, the beneficiary receives a higher income than the minimum wage but the firm pays lower variable costs.⁹ The State would finance such benefits through the general tax system—perhaps establishing special rates for firms according to their value added—and would thus reduce the disincentive to the recruitment of personnel requiring an additional minimum income.

Perfect coverage cannot be achieved either: some of the poorest people might be left out, or some who are not might be included. In order to ensure that none of the most disadvantaged are excluded and to generate political support for the programme, it is better, when in doubt, to extend coverage.

Table IX-4
LATIN AMERICA AND THE CARIBBEAN: COMPARISON OF TRENDS IN MINIMUM WAGES, AVERAGE WAGES IN INDUSTRY
AND PRODUCTIVITY, 1970-1980 AND 1980-1990

	Percentage variations					
	1980-1990			1970-1980		
	Minimum wages	Average wages	Productivity	Minimum wages	Average wages	Productivity
Argentina	-32	-32	-22	-45	-10	13
Bolivia	-	-	-24	83	-28	15
Brazil	-46	13	-10	2	55	69
Colombia	14	20	9	27	-2	23
Costa Rica	19	5	-8	13	26	14
Chile	-25	7	8	29	11	0
Ecuador	-62	-	-11	104	63	80
El Salvador	64 ^b	-	-16	-	-	7
Guatemala	-22 ^b	6 ^b	-19	-16	-37	30
Haiti	-	-	-22	-	-	30
Honduras	-26 ^b	-10 ^b	-20	-22	6	25
Jamaica	-	-	2	-	-	-23
Mexico	-56	-24 ^a	-17	10	15	36
Nicaragua	-	-	-42	-24	-26	-25
Panama	0 ^b	5 ^b	-23	-12	-2	20
Paraguay	28	8 ^b	-2	-34	-12	58
Dominican Republic	-	-	-10	-17	-5	37
Peru	-76	-56	-33	-25	-13	7
Trinidad & Tobago	-	-	-14	-	-	-
Uruguay	-29	-27	-5	-20	-52	27
Venezuela	-41	-35 ^b	-24	-30	6	-21

^a Estimated on the basis of GDP variation/working age population (15-64 years).

^b 1980-1989: Regional Employment Programme for Latin America and the Caribbean, Empleo y equidad: desafío de los 90, Documentos de trabajo series, No. 354, Santiago, Chile, 1990.

This of course entails fiscal costs which could be reduced administratively through simpler schemes and wider coverage.

In the specific case of minimum income policies, they could be focused on the poorest families, paying allowances only to the heads of low-income households. As the chances of these heads of household coming from poor family backgrounds are much higher than those of a typical low-income wage earner (the most subject to the minimum wage), paying them special allowances would benefit poor households more than minimum wages. For example, the allowance could be restricted to low-income wage earning heads of households (earning perhaps less than one and a half times the minimum wage),¹⁰ or those whose families are most probably poor. Similarly, a fixed or variable sum could be paid in proportion to the number of dependents between 5 and 18 years of age or to those enrolled in the educational system,¹¹ and it would hence become a sort of family allowance with graduated rates according to income (such as the system introduced in Chile in 1991). Thus, instead of benefiting, for instance, the poorest 20% of wage earners—which is what would happen if the minimum wage were raised—the allowance would benefit the same number of persons but would concentrate on those who most probably belong to poor households—the heads of low-income households. Moreover, it would do this without discouraging firms from hiring them.

Not only does minimum household income not encourage unemployment but it could also even bring about a reduction in the unemployment rate of heads of household (at the expense of those who are not heads of household). Since the allowance is paid exclusively to heads of household, the same job could be more profitable for them than for other workers, and it would therefore be reasonable to assume that the former would tend to displace the latter.

ii) *Indirect effects that should be kept in mind in designing minimum household income policies.* Minimum household income policies

have two positive indirect effects. First, their financing is neutral, as it comes mainly from general taxes that do not have an impact on the allocation of resources among factors and between small and large enterprises. Thus, their funding does not affect levels of employment and the distribution of such employment between big and small firms beyond what is required by the current economic situation.

On the other hand, although the financing of minimum household income policies may not have an adverse effect on the fiscal budget, their implementation should not generate inflationary pressures. A rise in the special minimum income allowance would not have an impact on the wage structure; if it did, it would be less than the effect of an increase in the minimum wage. The minimum income does not affect the base wage of unskilled workers, whereas the minimum wage does. Should the minimum wage increase it could produce many different effects on the rest of the wage scale. Pressures from the minimum income, on the other hand, would be exerted on the fiscal budget to expand coverage of allowances and not on firms to demand higher minimum wages.

There are also disadvantages to applying the minimum household income policy. These arise in situations of monopsony and recessions as a result of insufficient aggregate demand (where it is preferable to apply minimum wage policies). In such an economic context, allowances could favour the employer more than the worker by subsidizing the demand and not the supply of labour.¹²

On the other hand, in situations of full employment (especially of heads of household) or recession (not caused by sales restrictions but by foreign exchange),¹³ the entire minimum household income will benefit the worker. In such cases, the minimum income is the best instrument: it does not generate unemployment, is not inflationary, has a cost that is distributed equitably between firms and favours the poorest segments of the population. Moreover, it tends to promote the employment of heads of low-income households as wage earners. Finally, it is a dignified way of raising incomes since it

supplements the incomes of heads of households when they are *working*, in contrast with other supplements or subsidies that are granted only when the recipients are *unemployed*.

Notes

¹ ECLAC, *Sustainable Development...*, *op. cit.*

² See, for example A. Uthoff and R. Szlachman (eds.), *Sistema de pensiones en América Latina. Diagnóstico y alternativas de reforma: Costa Rica, Ecuador, Uruguay y Venezuela*, Santiago, Chile, Joint ECLAC/UNDP Regional Project "Finance policies for development", 1991; C. Mesa-Lago, "Aspectos económico-financieros de la seguridad social en América Latina y el Caribe. Tendencias, problemas y alternativas para el año 2000", document prepared for the Technical Department of the World Bank, 1990, and W. McGreevey, *Social Security in Latin America. Issues and Options for the World Bank*, World Bank Discussion Papers series No. 110, Washington, D.C., World Bank, 1990.

³ There are two dimensions involved in the expansion of social security coverage: risks and population. The expansion of coverage of risks has been much faster than the expansion in the coverage of people. In general, risks have been covered in the following order: first, occupational accidents and illnesses; second, non-occupational diseases and accidents, and pregnancy of working mothers; third, the pregnancy and illness of dependents; fourth, old-age and disability pensions; fifth, survivors' pensions; and sixth, family allowances and unemployment benefits.

⁴ For example, health care is usually the same regardless of the contribution (what matters is the fact of being covered; contributing more does not improve the care); similarly, old-age pensions depend in most cases not so much on the contribution of the worker throughout his working life but rather on his contribution from his last few years' income. Thus, the worker does not receive 100% value of his social security contributions.

⁵ José Wurgaft (ed.), *Empleos de emergencia*, Santiago, Chile, Regional Employment Programme for Latin America and the Caribbean (PREALC), 1988, and G. Rodgers (ed.), *Urban Poverty and the Labour Market. Access to Jobs and Incomes in Asian*

and Latin American Cities, Geneva, International Labour Organisation (ILO), 1989.

⁶ See, for example, Molly Pollack and Andras Uthoff, *Pobreza y empleo: un análisis del período 1969-1987 en el Gran Santiago*, Documentos de trabajo series, No. 348, Santiago, Chile, Regional Employment Programme for Latin America and the Caribbean (PREALC), July 1990.

⁷ See Regional Employment Programme for Latin America and the Caribbean (PREALC), *Empleo y equidad: desafío de los 90*, Documentos de trabajo series, No. 354, Santiago, Chile, 1990.

⁸ These funds include the Social Investment Fund (FIS) in Bolivia; the Solidarity and Social Investment Fund (FOSIS) in Chile; the Social Investment Fund (FIS) in El Salvador; the Social Investment Fund (FIS) in Guatemala; the Social Investment Fund of Honduras (FHIS); the Emergency Social Investment Fund (FISE) in Nicaragua; the Social Emergency Fund (FES) in Panama; the Emergency Social Investment Fund (FISE) in Uruguay; and the Venezuelan Social Investment Fund (FONVIS). Similarly, in Mexico, the National Solidarity Programme (PRONASOL) has been established; although it does not have the structure of a fund its aims are the same as those of the above-mentioned funds.

⁹ The benefits paid as additional income to the worker are tantamount to the family allowance in many countries of the region. Society wants to provide benefits to workers with more dependents who cannot meet their minimum needs from their wages. But instead of making the firms that employ the workers pay for this obligation directly—which would be a disincentive for hiring workers with dependents—society assumes this obligation and finances it through the general system of taxation. The direct hiring costs are the same for the firms and are based on considerations of productivity. The costs of making up the deficit with respect to household needs are charged to the fiscal budget. The firm does not reduce the number of workers with many dependents it employs, and such workers receive incomes with two components: one that is proportional to their productivity and is paid by the firm, and another which is proportional to the deficit in relation to their household needs and is paid by the government.

¹⁰ Of course, for practical reasons (that is, to avoid a marginal tax of over 100%) the benefit would have to be extended to groups earning higher

incomes, perhaps up to about twice the minimum wage. Otherwise, a head of household whose income was above one and a half times the minimum wage would cease to benefit from the allowance and hence his final income would be lower than that of the worker who earned less than one and a half times the minimum wage but received the allowance.

¹¹ If the amount of the allowance per dependant were high enough it could encourage people to have more children instead of benefiting the poorest. Therefore it is suggested, in such cases, that it be limited to school-age dependants.

¹² This occurs in addition to administrative problems that need to be monitored such as when

there is collusion between the employer and the worker and the real wage is underdeclared in order to obtain the allowance. To control such situations, widely extended pension plans where incomes are not underdeclared, or a system of taxation on the value added where wages are well under control, are required.

¹³ In recessions caused by foreign exchange restrictions, there is usually a negative correlation between real wages and the level of production, usually because the exchange rate rises in such situations. It should be noted that recessions caused by foreign exchange restrictions occur much less frequently in open, small economies.

Chapter X

EMPOWERMENT, CHANGING PRODUCTION PATTERNS AND SOCIAL EQUITY

1. Introduction: the challenges of democratization

The consolidation of pluralistic and participative regimes will heighten the demand for social equity in the region. As postulated in *Changing Production Patterns with Social Equity*, dialogue and consensus-building, the basic pillars of democratization, are means of settling conflicts without jeopardizing the requisites of stability and credibility.¹ In turn, the changing of existing production patterns requires many forms of institutional innovation, including the restructuring of enterprises, changes in labour relations, linkages between the public and private sectors and spatial decentralization. The essential task involved in the building of democracy is not only to absorb these demands for innovation but also to ensure that they are met in a context of empowerment and consensus-building.

The desirable paths to democracy and the viable means of modernizing society cannot be expressed in a single, clear formula. On the one hand, the determined, systematic absorption of technical progress into the production process with the results of this taking the form of higher real wages, requires an open willingness to negotiate on the part of entrepreneurial agents. It also means that the State must have the political capacity to respond to the adoption of agreements between the agents of modernization in an effort to transform the production system. On the other hand, the incorporation of technical

progress into productive activities is neither a politically neutral nor neatly rational process, because it takes place within a distributive struggle among the various social agents for resources of various kinds, such as spending on education and vocational training, credit to small businessmen and women to augment their inversion in fixed capital, selective subsidies or investment in public education. All these are part of the package of instruments needed in order to disseminate technical progress; at the same time, however, they act as a political response to the interplay of demands expressed by groups having varying abilities to exert pressure on the government, and to the dynamic interaction between public and private agents.

2. Empowerment and social equity

In the current environment of budding democratic institutions, the challenge consists in creating and strengthening positive linkages between political empowerment and social equity, recognizing a political dimension in the latter. This dimension means that the most marginalized and vulnerable sectors should have channels of expression to allow them to have a voice in the social agents' demands with regard to the allocation and use of resources, whether they be fiscal revenues, economic or cultural resources or access to power. The political dimension of social equity is decisively important in the countries of the region, where

a huge majority of the population (who are geographically, occupationally and socially marginalized or dispersed) meet with serious obstacles with they attempt to express their demands to the competent agencies.²

For purposes of both analysing the situation and proposing solutions, the political dimension of social equity can be evaluated from two perspectives: first, that of the social agents and their relationship with political and administrative structures, and second, that of the smallness and disaggregation of demand.

The former has to do with the prevailing relationship between the socio-economic conditions of a given social agent and the degree of influence he or she has on public and political decisions which affect his or her lifestyle and work situation. These conditions include a combination of elements: form of interaction with the productive structure (more or less modern, more or less formal, greater or lesser income-earning potential); level at which his or her basic needs are met; access to, and quality of, basic public services; conditions of the immediate physical environment, both in the workplace and at home; and opportunities for self-affirmation and cultural development in the broadest sense.

In turn, social equity depends on the ways in which government and political decision-making structures meet the demands made of them by the public at large. In this respect, it is important to take into account how the various pressure groups affect political and institutional structures; what type of relationships are established with these groups or agents and how these are biased in favour of or against some of them; and how these political and institutional structures incorporate the agents' demands into public policies which influence the social allocation of resources and affect the content and scope of the interaction between the State and the public in general.

Secondly, the problem of smallness of scale is linked to the level of disaggregation of the collective demands which are taken into consideration by the State and political system at their various decision-making levels. Thus, a

system will be more politically equitable if it can count among its achievements the progressive extension of the degree of democratic decentralization of empowerment. More equity will also exist if the political parties expand their ability to represent the demands of local and community agents, not just sectoral demands, and if, in the process of policy design, management and execution, closer communication is sought with the sectors which are most marginalized from the modernization of production and existing social services.

3. Inequality of social agents and their relationship with the State

The societies of the region exhibit very uneven levels of socio-political organization and ability to pressure the government agencies involved in institutional reform and resource distribution. This disparity has a number of manifestations: atomized agents in the so-called grass roots, who with great difficulty manage to form a nucleus for the purpose of undertaking piecemeal negotiations with the State or municipality; loss of legitimacy and ability to mobilize on the part of traditional trade-union organizations, either because of internal weakness or because a high percentage of the manpower entering the workforce is doing so at the informal level; and the growing economic power of pressure groups, which are increasingly tending to organize themselves in corporatist ways to discuss and negotiate their immediate and strategic demands.

This situation represents a considerable obstacle in the changing of existing production patterns, since it is precisely the most disadvantaged and least institutionalized sectors which ought to benefit from equitable policies. Moreover, the existence of large pockets of poverty and frustration means not only a loss of income and well-being for the society at large: the danger of social imbalances also undermines the very viability of the development process as a whole. Since the type of economic and social policy which encourages the simultaneous development of competitiveness and social equity

is aimed at fostering greater popular participation in institutional reform, resource management, access to services and programme execution, a political complement is needed, namely, the representation of the demands of these sectors in political party discourse, in public debate and in taking the decisions which affect policy design and the allocation of government spending.

A *sine qua non* condition, then, is that the marginalized actors themselves be able to open up channels that will give them a voice in the process of expressing demands and taking decisions. This brings up such topics as how to incorporate popular initiatives for purposes of exerting more pressure towards democratizing the political system and the government's social allocation mechanisms; the ways in which wide segments of the population express their desire to reduce or eliminate corruption, clientelism and bureaucratization in decision-making processes; popular demands that could be converted into linchpins of social mobilization, providing a political substratum which would give impetus to the changing of production patterns with social equity; and the most effective mechanisms of intermediation between the demands expressed and the real possibilities for meeting them.

It is not a question of merely facilitating the organization of underprivileged groups and the transmission of their demands. The challenge consists in ensuring the discussion of these demands through broad-based interaction among various social agents, within institutional channels which promote social equity without bringing about social excesses that would undermine the whole effort to change existing production patterns with equity. Although in order to achieve this goal the marginalized groups' ability to express their demands must be strengthened, it is also necessary to reinforce many different consensus-building and mediation mechanisms, including political parties, non-governmental organizations, legislatures, municipalities and decentralized regional councils. This will help to transform potential conflict situations into negotiation processes

—characterized by the acceptance of common rules of the game, a shared view of the major strategic lines of development, respect for the demands of each social agent and recognition of the abilities and limitations of the agents themselves to solve their own problems— as well as the real possibilities for the community and the State to help them.

Since the State is the main provider of basic social services to the region's most disadvantaged sectors, institutional reforms should also be considered in order to strengthen the national social sector as a receiver and transmitter of social demands within the State system of redistributive agencies.

In the urban poor sectors and in widespread segments of landless rural dwellers, geographical marginality is compounded by the informality of the labour market. Both the economic crisis and the migration-driven imbalances in many countries of the region have led to a steady increase in the number of urban, marginalized workers in the informal sector and to the breakdown of rural sectors. Low levels of institutionalization, little voice in public debate and decision-making and the atomization of their demands reflect the marginal empowerment situation of these agents.

Traditionally, the institutions that were set up to coordinate political proposals allowing for social participation and the expression of demands did not necessarily help to promote equity. They now appear to have serious shortcomings as a means of paving the way for a pattern of modernization and international reintegration which would have wide support among very diverse economic agents.

A major problem in this area is the persistence of kinds of linkages between social and political agents which restrict democratic participation, such as clientage tactics and corporatist relations between private pressure groups and government enclaves. These features adversely affect the transparency of, and public control over, decisions on the social allocation of resources (decisions which influence social and tax policies and management of the distributive aspects of economic policy

instruments). The considerable influence of the most economically powerful agents, budgetary constraints in the government social sector, the dispersion of low-income sectors, together with the limitations imposed by adjustment mechanisms and by the international financial system, constitute enormous stumbling-blocks in the effort to empower those sectors whose demands are precise reflections of the most urgent needs.

These circumstances affect not only the government's political capacity but also the role of the political parties as mediators between the social agents' demands and the State. The parties are faced with many challenges in their position as "gatherers" and mediators of social demands. In the first place, the degree of complexity of Latin American and Caribbean societies makes this party function difficult to carry out, in the face of actors with very different demands, disparate levels of institutionalization and heterogeneous ways of interacting with the production sphere. Secondly, the parties find themselves in growing difficulties because of the corporatist relations between the State apparatus and the production agents.

This series of problems also affects consensus-building efforts between the government and the various social agents. Political consensus-building is a democratic instrument for the incorporation of demands into decision-making processes; country-level experiences in consensus-building in recent years show, however, that these efforts have led in other directions. Initially these experiments were focused on creating appropriate conditions so as to ensure the transition from authoritarian regimes to democracy, regulating relations between civilian governments and the armed forces, rebuilding democratic political institutions and moving in the direction of reforms, although at times minimal ones, in State structures. Today, consensus-building processes in the countries of the region concern short-term economic policies, price and wage regulation and the administration of relations between the State, entrepreneurs and trade unions.

On the other hand, consensus-building processes have generally not attempted to address the basic demands of the neediest sectors. In fact, little attention is paid to the linkages between political consensus-building and social policies. Moreover, conciliation of demands is being constrained by the differences between the various social agents in terms of their ability to exert pressure, and the State's propensity to negotiate with organizations which are already part of the modern economy or were formerly connected with the political institutions of the State itself.

These difficulties are related to others of a governmental and institutional nature which are not necessarily political, and have to do with the activities of State agencies or the public sector; these last-mentioned operate on the basis of self-serving logic, without taking into consideration the demands expressed by those agents who should be the ultimate beneficiaries. In a number of areas where policies are managed, designed and executed, well-known obstacles must be faced: the tendency towards bureaucratic ritualism; the impermeability of policy-makers in the face of changes in the needs of the most disadvantaged groups; lack of feedback from the least productive agents; sectoralization and proliferation of feuds in the national social sector; unnecessary competition in decision-making and in the execution of social programmes; jurisdictional conflicts between institutions within the State apparatus; and paternalism.

4. Decentralization and small-scale problems

Decentralization plays a decisive role in the democratic discussion of social demands in that it makes it possible to strengthen the ties between government activity and the participation of regional and local agents in government decisions. In fact, a strong trend towards decentralization can be noted in the region, both in terms of the legislative and constitutional changes which modify the

institutional organization of the State and in terms of the demographic movements which back it.

Thus, for example, the large federalist countries have affirmed the intention to decentralize: Brazil, in its 1988 Constitution, expanded decentralization and direct participation through popular initiative and the referendum; and Venezuela, in its 1988 and 1989 amendments to the Basic Law of the Municipal System, reinforced and placed special stress on the functions of its municipalities. Similarly, various laws have recently been adopted which introduce significant changes in the non-federalist countries, including the following: in Bolivia, a decentralization process has been encouraged through the Basic Law of Municipalities of 1985; in Colombia, a fiscal decentralization act increased the participation of local governments in national tax collection (see box X-1), while the popular election of mayors was also approved in 1986; in Guatemala, the Constitution which came into force in 1986 established regional and departmental levels of jurisdiction and allocated 8% of the central government budget to the municipalities to finance infrastructure works and public services; in Chile, the 1991 constitutional reform and the regional, municipal and municipal-revenue laws that are expected to be passed point to a far-reaching process of decentralization; and in Peru, the 1979 Constitution provided for a regional State, a combination between a unitary and federalist system.

At the same time, the legislative trend towards decentralization has probably been influenced by demographic and urbanization movements which indicate the growing importance of the small and mid-sized cities in the region in the past 20 years. Thus, the number of cities with more than a million inhabitants rose from 7 in 1950 to 18 in 1970 and to 38 in 1990, of which only 5 were metropolises with more than 5 million inhabitants (see table X-1). The strongest population growth took place precisely in the

new cities of intermediate size. The 31 cities which passed the million mark in 1990 (which had not yet reached that figure in 1950) increased their share in the urban population from 15% in 1950 to over 20% in 1990. A similar phenomenon to that of cities of over a million inhabitants can also be seen in the case of smaller cities.

In view of this trend, the administrative and political obstacles to decentralization need to be identified. A frequent stumbling-block is the persistence of a politico-administrative division in the countries and a body of legislation on municipalities and other decentralized powers which entrusts the local authorities with the execution of public works, but yet inhibits them from fulfilling their potential to act as political representatives of the local population under their jurisdiction. The possibility of local authorities acting as the principal mediators between local demands and decision-making public bodies is also hampered by the shortage of resources generated by the municipalities themselves and by the existing bottleneck in flows from the State to poor municipalities.

Another obstacle is the reproduction of spurious forms of linkage with the community at the municipal level, modelled on the global relations between the political system and the society at large, i.e., the municipal officials' centralist view of the country's administrative authority; duplication of authority and feuds between the various political clientele at the local level; and lack of transparency in the processing of demands from the local population. Political measures, such as popular election of mayors and governors, are necessary but insufficient conditions for correcting these distortions. The problem of scale in the democratic processing of social demands is related to the proliferation of special demands from small groups, and the consequent difficulty of communicating them to the bodies which determine the allocation of resources, or of these bodies' responding to the groups seeking to interact with them.

Box X-1

**COLOMBIA, ACT No. 11 OF 16 JANUARY 1986: A CASE OF ADMINISTRATIVE
DECENTRALIZATION WITH THE EMERGENCE OF DEMOCRACY**

Act No. 11 of 16 January 1986 sets forth legal and administrative regulations aimed at optimizing the participation of organized community groups in local government, and especially in the design and execution of social policies at the local level. It therefore provides for the establishment of three new administrative functions, as follows:

- Local administrative boards (articles 16 to 21) are established in urban communities of at least 10 000 inhabitants and in rural jurisdictions to encourage the municipality to provide better services and streamline its administration. Its functions specifically include budget planning, recommendations for approval of taxes and contributions, and supervision and control of municipal services. Pursuant to this legal provision, no less than one third of the board's members shall be elected by popular vote of the inhabitants of the sector.

- Community participation (articles 22 to 25). On the basis of these provisions, all civic boards and organizations which have been constituted in accordance with law and which operate on a non-profit basis shall be empowered to establish joint agreements and conventions with the municipality for the purpose of channelling individual and separate efforts towards the solution of common problems relating to unmet basic needs in the municipality's area of jurisdiction.

- The presence of community demands in local provision of public services (articles 27 to 35). Pursuant to these provisions, users of public services shall participate on the boards and councils in charge of providing such services. For these purposes, Act No. 11 of 1986 authorizes the municipalities to make contracts with community action boards, renovation and refurbishment associations and recreation, civil defence and user boards and organizations for purposes of carrying out functions or providing services; and provides that one third of the members of the boards of directors of public service enterprises shall be representatives of civic bodies or users of these services (decree No. 3446 of 1986).

Mention could also be made of two constitutional provisions having to do with administrative decentralization: Legislative Act No. 1 of 1986, which institutionalizes local referendums; and article 9 of Act No. 76 of 8 October 1985, concerning community participation in regional planning. This article calls for the establishment of a committee on concerted development efforts, to act as an advisory body to the regional economic and social planning councils, in which various community and trade-union representatives in the region would participate.

Source: Federación Colombiana de Trabajadores Sociales (FECTS)/Consejo Nacional para la Educación en Trabajo Social (CONETS)/Asociación de Trabajadores Sociales de Santander (ATSSAN), "Democracia, participación social y trabajo social", *Memorias del 6º Congreso Nacional de Trabajo Social*, vol. I, Bucaramanga, Colombia, 22-25 June 1988.

With regard to the problem of scale, not only are obstacles faced in relation to decentralization or spatial deconcentration of power. What is also especially critical is the linkage between community organizations and public authorities, especially in the case of small organizations, such as neighbourhood or ecological movements. An awareness exists that many of these community organizations could coordinate the participation of marginalized groups in the management of basic services, and this would at the same time trigger a process of feedback and convergence between demands and real possibilities of meeting them.

Various demands could thus be dealt with effectively and in a decentralized way: empowerment of the poorest sectors in the management of social programmes; empowerment of neighbourhood organizations in decisions on the channeling and social use of resources at the local level; greater State and private support for non-governmental organizations working closely with low-income sectors; adaptation of health services, public education and low-cost housing programmes to the specific needs felt by the various groups; and greater access to and presence in the mass media.

Table X-1

LATIN AMERICA: CONCENTRATION OF THE POPULATION
IN LARGE CITIES, 1950-1990

	Cities of 1 million or more inhabitants in:				Cities of 5 million or more inhabitants in:			
	1950	1970	1980	1990	1950	1970	1980	1990
Number of cities	7	18	23	38	1	4	4	5
Population (thousands)	17 099	56 803	84 707	132 245	5 042	32 899	45 275	66 057
Percentage of the total population	10.72	20.51	24.00	30.26	3.16	11.88	12.83	15.11
Percentage of the urban population	25.77	35.63	36.66	42.61	7.60	20.64	19.59	21.28
	Cities which had 1 million or more inhabitants in 1990				Cities which had 1 million or more inhabitants in 1950			
	1950	1970	1980	1990	1950	1970	1980	1990
Number of cities	38	38	38	38	7	7	7	7
Population (thousands)	26 931	69 008	97 583	132 245	17 099	38 648	52 081	67 840
Percentage of the total population	16.88	24.91	27.65	30.26	10.72	13.95	14.76	15.52
Percentage of the urban population	40.59	43.29	42.23	42.61	25.77	24.25	22.54	21.86
Average annual growth rate (per thousand)	47.05	34.65	30.40		40.77	29.83	26.44	
Primacy index (per thousand) ^{a/}	3.22	-2.48	0.90		-3.04	-7.31	-3.06	

Source: CELADE, *Latin America: Percentage Urban, 1990*, Demographic Bulletin series, No. 47 (LC/DEM/G.97), Santiago, Chile, January, 1991; United Nations, Department of International Economic and Social Affairs, *World Urbanization Prospects* (ST/ESA/SER.A/121), New York. United Nations publication, Sales No. E.91.XIII.11.

^{a/} Corresponds to the annual average growth rate of the percentage of the urban population living in cities of a million or more inhabitants.

However, problems of scale persist: the lack of opportunity to reproduce experiences, which often do not go beyond the pilot project stage; the difficulty faced by community agents in their attempts to change the social allocation of resources of various kinds, owing to their low level of influence and the fact that the parties find it difficult to incorporate "molecular" demands; and, especially, the marked discontinuity of community organizations, most of which soon give up in frustration, and their precarious, short-lived existence. This poses a challenge to democratic regimes which is both complex and motivating: How can participation in community organizations be institutionalized in the decision-making bodies of the State apparatus, without destroying these organizations' desire for autonomy and active participation? The need arises here to discuss concrete factors to facilitate decentralization in a democratic and participative environment.

One relevant example is the environmental dimension of the local development process. Participative management formulas could be tested for addressing a number of environmental problems; these formulas—besides dealing with problems which have been largely ignored and which affect the living conditions and health of the poorest sectors—could help to strengthen and reinforce democratic systems.

There are at least four reasons to justify the mention of the environmental question as a relevant example: first, it concerns concrete, daily problems and situations with regard to which at least some interaction and communication among various groups and social actors are generated, making knowledge about the problems more uniform and providing opportunities for consensus-building.

Second, divergent or conflicting interests among the relevant groups or social agents with regard to many of these environmental problems can be detected and identified fairly clearly, and this can help lead to negotiation, arbitration and the reaching of compromised solutions.

Third, since environmental problems are practical ones which require concrete solutions, the local political agenda can focus on topics

with little ideological content and exclusivity, offering greater stability to the democratic process.

Fourth, dealing with environmental issues simplifies the matter of involving groups and individuals who are not members of political parties in decision-making processes, which forces the parties to continually update their interpretation of the demands and hopes of the people, thus enriching the participative processes.

5. Courses of action

Although the redistributive effects of changing production patterns could have a positive impact on wage-earners in the modern sectors of production of goods and services—especially through the political negotiation of broad agreements between entrepreneurs, workers and the State—the outlook is less clear for the population of the countries of the region which still participate only marginally in development, maintain very low levels of productivity in the informal sector, and are located in marginalized urban zones or are dispersed in the rural areas.

The effectiveness of consensus-building in terms of incorporating the demands of the disadvantaged into political negotiation and policy-decisions is uncertain. Their threefold situation of economic, geographical and political marginality dooms them to remain dispersed and atomized. The incorporation of political consensus-building efforts requires the creation of new channels of representation and new forms of linkage between the political system and the so-called "grass roots". There are many challenges in this area, and many such actions could come into conflict with the political stability required for changing existing production patterns together with the liberalization of international markets, owing to the possible disruptive effects of these efforts.

These considerations mean that special attention must be given to policy lines designed to attenuate the levels of political inequity. For

this reason, only a few courses of action are proposed, in two specific fields: first, coordination and interaction among the various social agents and the State, and second, efforts to deal with the problem of scale. In both areas, the stated objective is that the demands of the disadvantaged poor sectors be processed by various political and public agents so that they can be incorporated into decisions being made concerning policy design and resource allocation.

Accordingly, the proposal is not to create a single, comprehensive consensus-building mechanism but rather to open up fresh channels for reaching consensus in specific fields where decisions impact on the level of productivity and well-being of the social agents who are most excluded from the fruits of development, and where the influence of the actors' participation in public decision-making processes could be broadened, and this would have a redistributive effect.

- a) *Social agents and their relationship with the State*
 - i) *Multi-institutional initiatives for incorporating social demands into the design of comprehensive social development projects*

Multi-institutional initiatives to develop intersectoral, comprehensive programmes, such as training and advanced training of human resources in low-productivity sectors, are a proven form of advancement. Social investment funds represent an attempt to take advantage of such experience to coordinate public programmes with the demands of the community itself (see box X-2).

For example, preschool care in depressed areas could be encouraged with the help of local governments, Church-related community organizations, non-governmental organizations and the national social sector, assigning priority to the needs of female-headed households and ensuring the active

participation of mothers and their families. Similar steps to improve school enrolment in poor areas would enable education to be adapted to the special characteristics of local needs, in order to promote greater continuity and a type of educational content that would be in line with the economic and productive activities most familiar to the students, whether in the context of families, communities or local regions. Local governments, government training services and non-governmental organizations working in rural sectors could also join in, so that the school could serve as an institutional base for carrying out rural training programmes and arranging credits for small farmers; at the same time it could become a propagating agent in such areas as the adoption of technologies, agricultural experimentation workshops and community organization.

A score of collective associations have been set up in the informal sector for the common solution of basic income-related problems. The production workshops in this sector are small, self-managed units composed of a few workers, with a rudimentary division of labour, and they produce low-technology goods. If the efforts being made by various bodies which sponsor production workshops (non-governmental organizations, national training and study institutes and parochial centres) were combined in an attempt to come to agreement on national policies, this could have a significant mobilizing effect on other sectors, leading to university extension programmes to reach the production workshops, subsidy policies to absorb technology into the workshops, credit facilities for the self employed, etc.

- ii) *More linkages between activist organizations from the sectors receiving the fewest benefits from modernization*

Until now, most of the organizations formed by marginalized sectors have been either subordinately linked to political parties or have had sporadic contacts with the government in

Box X-2

**SOCIAL DEVELOPMENT FUNDS AS A TOOL FOR STRENGTHENING THE
ROLE OF NON-GOVERNMENTAL ORGANIZATIONS IN POLICIES TO
HELP THE POOR: A PRELIMINARY OVERVIEW OF
THE REGION**

In recent years, and especially in 1990, special funds have been established in many of the countries of the region to finance social actions targeted at the poorest sectors and those most severely affected by the adjustment process. One of the most innovative features of the region's social development funds is the relationship established through them between the government social apparatus and the civil society. These funds have been regarded as participative institutions for the purpose of promoting social organization, so that the grass-roots communities can join in solving their own problems. Accordingly, these funds collect resources which can be used without having to deal with the bureaucratic inertia and verticalist biases which often plague the public sector. Three common features of a number of different national experiences may be pointed out in this context: promotion of empowerment, the protagonistic role of non-governmental organizations and the inclusion of private-sector representatives in executive and administrative bodies.

In the case of the Social Solidarity and Investment Fund (FOSIS) in Chile, social organizations participate in determining which resources the Fund will manage, how they will be financed and the planning and allocation of expenses. In Guatemala, the fund concept is based on the active participation of existing organizations working with community groups such as non-governmental organizations, cooperatives and other associations. Various government agencies have launched programmes to encourage the active participation of non-governmental organizations in particular, so as to identify the needs felt by local communities and to encourage participative programmes to meet them.

order to negotiate their interests. To remedy this situation, three possible steps could be taken: increasing the capacity for relatively well-organized popular social movements to exert pressure; improving the organizational capacity of the most atomized, disadvantaged agents; and ensuring better coordination among the various community organizations. Coordination in this sense means a dense network of social movements which are capable of perceiving their immediate and strategic demands, in order to exert pressure on the relevant decision-making bodies while at the same time becoming familiar with the existing conditions of political and economic feasibility; thus they are able to recognize this feasibility and use it to their own benefit, where appropriate.

A number of general guidelines could be useful for coordination among organizations of marginalized sectors. First, it would be advisable to disseminate new information and telecommunications technologies to the rank and

file. This would have a synergetic effect on horizontal coordination between grass-roots organizations having common needs and demands. At the same time, it would allow for the establishment of channels of communication to help provide the most atomized sectors with access to already established social movements whose demands are similar to their own and to build a framework of social movements depending on shared interests and demands.

The establishment of information networks would be a valuable contribution to such linkages. These are very useful, affordable and user-friendly instruments, and at the same time provide a feedback mechanism which can help to situate both demands and consensuses in a broader context of participation and convergence of interests, congruent with their political feasibility. The effects of telematics can be wide-ranging and decisive (see box X-3).

Second, a new definition of cultural policies is needed, based on the organizational patterns of the low-income sectors. The

Box X-3

SOCIAL EQUITY AND THE SYNERGETIC EFFECTS OF TELEMATICS

The dissemination of telematics (a combination of telecommunications and information technologies) opens up a good many possibilities in the various areas of political equity. Increasing affordability, miniaturization and user-friendliness and the ease with which these technologies can be put to many different uses makes them ideal for purposes of coordination among very diverse or dispersed agents. Telephones can be used without operators, computers without programmers and libraries without librarians; radio stations can be operated without engineers; films can be made without professional film makers; and newsletters can be published without a printing press. Despite these advantages, the "telematics connection" has thus far been underutilized in government processing of the demands of the most scattered or excluded agents.

At the level of social agents, the absorption of these technologies could be a decisive factor in increasing political equity. First of all, the installation of low-cost, user-friendly terminals connected to a database provides rural dwellers and small entrepreneurs access to information on areas of interest, such as special credits and technical cooperation. Establishing linkages between these agents on the one hand and the State social sector on the other, through the use of these new technologies, would make it possible to constantly update training programmes, improve the channelling of credit to small entrepreneurs and locate transport and energy services and infrastructure when needed. Secondly, the fact that these technologies are available for data processing and telecommunications could exert a synergetic effect on the coordination of demands among grass-roots organizations. Precedents do exist in this regard. In Guatemala, campesinos who do not even know how to operate typewriters send facsimile human rights messages to non-governmental organizations. In Brazil's Amazon, pre-literate Indians now exchange video tapes of local customs. Telephone conferencing is already being used to coordinate efforts among a score of pro-environment groups throughout the region and even with some beyond national borders. Barrio associations in Mexico have increased their pressure on government to meet their demands by using computers, their own databases and inter-barrio information networks. Also in Mexico, campesino federations are building an independent database in order to have more control over rural credit programmes, thereby improving their negotiating position with the State banks. These isolated examples illustrate the synergetic potential of the dissemination of telematics in providing linkages between social agents, so as to increase their representation and ability to exert pressure on government decision-making bodies. This synergetic potential is self-evident in view of the wide range of opportunities which are opening up: access to information (on services, rights and common demands), influence on public opinion (through radio broadcasts, access to computerized networks or publicizing documentary tapes), aggregation of demand (through the use of databanks and greater "telematic connectedness"); and transcending the barriers of censorship (using horizontal networks for circulating information).

On a smaller scale, the absorption of telematic technologies could facilitate, in the first place, the management of planning by decentralized bodies, providing detailed maps of areas and critical needs, of the demands of small local organizations and of the location of investments with high potential social benefits. These technologies are also quite useful to agents in following-up and evaluating the effects of highly dispersed municipal programmes. The application of these technologies at the local level would paved the way for popular consultation mechanisms and the processing of neighbourhood and community surveys for detecting concerns and expectations among micro agents. It could also be very useful to have a computerized data bank at the local and provincial government level containing proposed mini projects for barrio organizations, micro business associations and campesino communities, where the processing involved in evaluating priority, feasibility and profitability could be carried out very quickly. Automatic data processing programmes for these purposes are low in cost and user-friendly.

Source: Sheldon Annis, "Giving voice to the poor", Foreign Policy, No. 84, 1991.

organizational culture which has developed outside modernization processes not only represents a pivotal factor in the survival of large segments of the poor, but has also enabled these sectors to devise collective ways of exerting pressure to meet their demands. The group culture in extensive poor sectors, including the world of indigenous Incas, Mayas or Aztecs and indigenous peasant organizations, as well as the urban peripheries, is an extremely dense, rich fabric. This type of action seems to have greater potential in countries having more indigenous people, such as the Andean countries, Guatemala or Mexico (see box X-4), or those who have a highly developed series of Church-related community organizations, as in Brazil.

Third, government initiatives to optimize the impact of social assistance through programmes of various types need to be strengthened. These would include low-cost self-help housing, disease prevention combined with the training of mothers in the most vulnerable neighbourhoods and preschool and nutritional care of children in community centres.

Finally, the role of the "external agent" provided by a non-governmental organization, a local government or a government programme in linking community-based social movements with trends in the society as a whole could be encouraged, thereby reducing existing levels of segregation and fragmentation. Its function, in this case, would be to offer support to grass-roots organizations to channel the expression of their demands or their participation-seeking activities in the same direction as national-level development, in relation to other social agents and in the current environment of political consensus-building. The agent should not take on the representation or leadership of popular organizations but should support these organizations where necessary. In this sense, the external agent could provide technical cooperation in organizational methods and information about public decision-making processes and about offers from, or constraints on, national social structures, information which

has often been unavailable to the grass-roots sectors.

- iii) *Increased capacity, on the part of government agencies in charge of managing public resources, to process the demands of the groups least incorporated into the benefits of modernization*

Institutional reforms to strengthen the State sector as receiver and processor of social demands within the system of redistributive government agencies should also be considered. There are no preconceived formulas for this purpose. It is evident that government bodies which process demands and translate them into policies, programmes and projects need to be reinforced. In some countries, the coordination of sectoral programmes into an integrated support strategy for the least productive and neediest sectors has been left to various public agencies, in the hope that these agencies would find legitimation through citizen support, parliamentary debate and pressure from political parties having deep roots in the low-income sectors.

In addition, agreement should be sought among the potential beneficiaries on implementing programmes to meet their demands. This sort of cooperation can be encouraged in a number of ways —through a close network of feedback between the national social sector and the target groups (mainly low-income sectors) to bring economic and social policy into line with the demands and needs felt by the popular sectors; design of a clear, intelligible and directly communicable strategy to carry out its programmes, objectives and stages; and dissemination of this strategy through the mass media, community leaders, non-governmental organizations working in low-income sectors and parliamentary debate.

The national social sector might also enhance its ability to receive the demands of the low-income agents so as to inventory and process them, incorporating them into the

Box X-4

**THE CAMPESINO AND INDIGENOUS MOVEMENT IN ECUADOR:
A CASE OF ORGANIZED COMMUNITY ACTION IN RURAL AREAS**

A number of different levels of spatial aggregation of demand exist within the *campesino*-indigenous movement in Ecuador. In the case of "unions", or "second-degree" organizations established within a parochial environment, the *campesino* community participates directly in the discussion of its demands. The provincial federations, for their part, are set up under an umbrella organization which fulfils a coordinating function for all community organizations in the province. Finally, the *campesino*-indigenous movement belongs under the heading of national trade-unions or ethnic organizations.

National organizations exert pressure for the demands of the whole *campesino*-indigenous sector to be met; these include land claims, demands for self-determination and multinationality, which are included in the current National Economic and Social Development Plan of Ecuador, and general economic demands. In the regional sphere, three strategic elements are involved in *campesino* and indigenous organizations: the struggle for land, resistance to racial discrimination and defence against the concentrating style of settlement which has been imposed. Most recently, demands for better living conditions have been expressed in demonstrations against the cost of industrial inputs and consumer goods and transport prices, problems concerning the marketing of commodities, price policies and agricultural policy.

The primary actors in the *campesino*-indigenous sector are peasant or indigenous communities in la Sierra, small highland settlements and the new indigenous nationalities living on the coast, in the Sierra and the East. The linkages that have been strengthened in this sector among activist organizations at community, provincial and national level have opened up opportunities for bargaining with the executive power and receiving increased coverage in the mass media.

Source: Project on Support for Social Development Planning, *Bases fundamentales para una estrategia de desarrollo social integrado*, Quito, National Development Council (CONADE)/United Nations Development Programme (UNDP)/United Nations Educational, Scientific and Cultural Organization (UNESCO)/United Nations Children's Fund (UNICEF), June 1991.

preparation of public action programmes and into the follow-up of policy execution.

iv) Better linkage between the political system and the agents and demands of the grass-roots sectors

One means of strengthening the feedback of information from agents and organizations dispersed throughout the low-income sector to the political system would be the creation of regular, joint discussion forums among representatives of the various technical levels of party leadership, including the legislature, grass-roots organizations with direct demands, non-governmental organizations with broad experience in the urban and rural low-income sectors and provincial and municipal authorities

which eventually absorb popular demands and devise ways to channel them.

To bring these efforts to fruition, a party system is needed, one that is able to act as an instrument for aggregating and balancing the demands of the various social agents. The establishment of automatic financial mechanisms to increase the degree of economic autonomy of the parties in relation to corporatist groups would be a step in that direction. Therefore, as part of the rules governing party work, special stress should be placed on the function of gathering, processing and balancing social demands by encouraging, for example, training, study, debate and advisory assistance activities within the parties themselves, while at the same time promoting the training of their middle executives.

Support for the organizational culture could also contribute both to the strengthening of parties and to the organization of marginalized groups. Traditionally, the cultural variable has formed part of populist party practice, more connected with the desire to encourage new members to join than with support for popular culture. To the extent that this strengthens the internal democracy of the parties having deep popular roots, and the organizational and activist cultures become more permeable in order to reinforce the autonomy of the agents who participate in these cultures, demands for cultural self-affirmation in the low-income sectors could be more firmly incorporated into government programmes proposed by the various candidates. These actions would help to overcome the shortcomings in terms of representation which stem from the disconnectedness and structural heterogeneity of the countries of the region. The broad spatial coverage of the parties and their grass-roots base gives them the foothold needed to foster the organizational culture of the low-income sectors.

Lastly, it is obvious that the legislative power, through the parliamentary process, could act as a coordinating body between the political system and the agents and demands of the low-income sectors. Functions which the legislature could carry out in order to incorporate social demands and needs into government debate include, for example, the setting up of multi-party commissions to systematize popular social demands and the preparing of thematic platforms by political consensus, seeking to balance the demands from the various social agents.

b) *Courses of action to address the problem of scale*

Solving the problem of smallness of scale begins with the strengthening of local Government. In fact, the region suffers from a sort of *undermunicipalization*, that is, a very low density of local authorities, especially in rural populations, with a limited set of powers. For

example, as can be observed in table X-2, there is one municipality for every 1 338 square kilometres of territory in Latin America, which represents a ratio 50 times less dense than that of Western Europe; likewise, the density of municipalities as a proportion of the population is one eighth that of Western Europe. Decentralization thus involves extending municipalization.

At the same time, to strengthen municipalization, a training and technical advisory assistance should be established to help manage the municipalities, reinforce the municipal financing system and provide municipalities with the capacity to take decisions and supervise the supply of services (health, education, sanitation, basic services, technical agricultural assistance, advisory assistance and credit for small businesses, and rules of safety) and the construction of infrastructure projects.

Although the municipal government would have the technical support (and even the technico-political support) of the central government apparatus, decisions concerning priorities in the allocation of resources, supplementary tax collection systems and design and execution of social programmes would be under local jurisdiction. The automatic allocation of a certain percentage of the national budget for municipalities would be a step towards the reinforcement of their financial autonomy. Technical training of municipal staff would in turn make it possible to give progressive technical autonomy to municipalities. Decisions for which the municipality should have autonomy with respect to the central Government could be gradually expanded, in accordance with the execution capacity of the municipalities themselves and their ability to process disaggregated demand in the territory under their jurisdiction.

Municipal autonomy does not mean that each unit would have to have a diversified technical apparatus, similar to that of the central government. The duplication of functions would entail a cost in terms of resources and energy which would countervene the very rationale behind decentralization. What should

Table X-2
DENSITY OF MUNICIPALITIES IN RELATION TO AREA
AND POPULATION

	Territory		Population of municipalities		Number of municipalities				
	Total (1)	Suitable for agriculture ^a (2)	(3)	Arable and pasture land (4)	(5)	(1/5)	(2/5)	(3/5)	(4/5)
	(Thousands of km ²)			(Millions of inhabitants)		(Thousands of inhabitants)			
Latin America ^a	20 877	17 134	7 518	439.3	15 600	1 338	1 098	482	28.2
Western Europe ^b	1 639	1 373	929	229.3	63 086	26	22	15	3.6
Eastern Europe ^c	441	389	256	53.5	11 300	39	34	23	4.7
USSR	22 402	15 492	6 042	288.7	48 296	466	321	125	5.9
Canada ^d	6 052	4 344	785	26.2	4 657	1 299	933	168	5.6
United States of America	9 372	6 965	4 313	248.0	19 200	488	363	224	12.9

Source: Prepared by the ECLAC/FAO Agriculture Division on the basis of the population censuses and statistical yearbooks of various countries; and Spanish Agency for International Cooperation, *Municipalidades en Centroamérica*, Madrid, November 1989.

^a Includes forests.

^b Includes only the Federal Republic of Germany, Spain, France, the Netherlands and Italy.

^c Includes only Czechoslovakia and Poland.

^d Does not include the provinces of the Yukon Territory and the North East Territories.

be developed, however, is a functional formula for coordination between municipalities and central agencies, in the form of technical support from the central agencies to the decentralized agencies.

Technical support would be intended to train municipal staff in critical areas such as the identification and appraisal of education, health, housing and town-planning projects, at the same time acting as a "bottom-up" channel for the demands of social micro-organizations in accordance with their spatial distribution. The municipality would act as a mediator between the State's technical capability and the social demands of its territorial area, and this mediating function would be the basis of its autonomy.

Municipal autonomy could be progressively expanded to various fields of local endeavour. The pilot areas for the exercise of this autonomy might vary from one municipality to another, and from country to country, depending on the prevailing phase of decentralization. It could initially deal with the improvement of the environment as a relevant factor in decentralization and empowerment; the localization of community development projects; the development of educational infrastructure in the neediest areas; or proposals for self-financing submitted to a popular referendum. If the goal, however, is greater participation on the part of the most disadvantaged sectors in decisions on resource distribution, it is important for the process of "municipalization" of decision-making to be supplemented locally with the participation of small, grass-roots organizations.

Many non-governmental organizations have acted at the local level in the past decade and have promoted a score of small-scale development projects with emphasis on innovative forms of social participation. Non-governmental channels have been opened up to encourage social development initiatives which are disseminated to the marginalized sectors of society. Beginning at a "micro level", these initiatives have made it possible to formulate baseline studies of the needs felt by

the most vulnerable sectors (and those made vulnerable by the crisis of the 1980s) and, on the basis of these studies, to suggest courses of action in which the participation of the target population and the mobilization of social creativity would be irreplaceable inputs. Because of the scarcity of physical resources and trained professionals, these local practices have used or generated unconventional resources, such as organizational culture, local management capability, popular creativity, mutual aid strategies and the preparation of community leaders. All this has occurred in many small-scale, low-income units, both urban and rural.

Thus, if enough political will is generated in the relevant government agencies to promote innovative forms of social participation, the work done in coordination with non-governmental organizations would be very useful in the formulation of future social policies for small-scale units. This is true for two reasons: there is an already established link between these organizations and small-scale groups and a comprehensive knowledge of their needs; and experts from these organizations have learned in their fieldwork how to develop strategies for mobilizing human resources, involve the target population and their demands in the design and execution of projects and enhance community motivation.

In order to capitalize on this accumulated experience, it would be advisable to set up a system of consultations between the government and non-governmental organizational networks. These consultations would be oriented towards a precise objective, namely, to optimize flows of public resources (central or decentralized, depending on the most effective formula) intended for social development projects proposed by the non-governmental organizations which have proven, successful experience in working on a small scale in poor sectors. A dual benefit could result from this. First, public social policies and programmes for broad sectors of the population would be complemented by a wide network of diversified actions which would bring out the most specific needs and demands of the disadvantaged in the cities and rural areas.

Second, social assistance projects could be replicated using already proven models of widespread participation by the target population.

To the extent that the spectrum of efficient, small-scale social assistance projects can be expanded, the more feasible it will be to translate disaggregated demand into redistributive efforts. Social investment funds, which are widely used in the region, are useful basis for carrying out this type of activity (see chapter IX, section 3 b), and box X-2).

Another useful space for incorporating the specific demands of small-scale social organizations could open up at the municipal level. In many countries of the region there are two types of grass-roots organizations "with a human face" in the poor sectors: neighbourhood boards, and *campesino* communities. Recent experiences in countries of the region demonstrate that potential low-income participation spaces exist in which territorially-based organizations are linked with municipal offices (such as for consumer protection, price control, the fight against corruption, demand for water and other services, primary health campaigns, environmental improvement, cultural mobilization and control of bureaucracy.

These initiatives could be institutionalized by creating a small-scale project bank. Projects would be proposed to the municipality by community organizations (with the technical support of the municipality or a non-governmental organization acting as mediator) and subjected to criteria of feasibility, relevance and profitability. For this purpose a special municipal fund would be needed to finance these projects, and a deliberating body in which the projects could be appraised, listed in order of priority and negotiated jointly with their eventual target populations.

Notes

¹ ECLAC, *Changing Production Patterns with Social Equity*, *op. cit.*, pp. 54-59 and 149-156.

² Since in many cases social policies have been instituted in response to the expression of social demands, the target groups have not always been the neediest, but rather those best able to exert pressure on the government through the channels open to them.