INVESTMENT IN ARGENTINA AND COLOMBIA DURING THE 1990s

As in all of Latin America, at the beginning of the 1990s Argentina and Colombia applied structural economic reforms that affected investor conduct, the structure of investment and the position of their various economic sectors in the international economy.

In Argentina, the Convertibility Plan anchored the national currency to the dollar, fostered an ambitious privatization program, deregulated the economy, opened up markets and changed the management of tariff policy and economic integration in MERCOSUR.

Colombia, under the Gaviria administration, liberalized imports (tariffs were cut and quotas were eliminated) and the exchange market (the band system was adopted), and embarked on a plan of tax and labor reforms, together with privatizations and concessions.

In Argentina, results were contradictory. Some areas developed swiftly during the decade, while progress in others was slower. As a result of two periods of stability at a time of crisis, national output in 1997 was 36% higher than in 1991. Investment grew by 115%, exports by 86% and imports by 222% compared with the earlier year. But unemployment doubled and a favourable trade balance in 1991 became a deficit in 1997.

The 1995 recession was one of the worst in Argentine history. National output fell by 4.5% and investment by 16%, while unemployment rose to around 19%. During the first quarter of 1995, SUS 3,100 million in private sector bank deposits fled the country. Nevertheless, the recession was overcome in two years.

In this context, the investment process was characterized by a growth in capital formation, especially as a result of foreign direct investment (FDI), with the public sector being displaced by private agents. Balance of payments estimates suggest that more than SUS 20 billion in FDI entered the country between 1990 and 1996.

Overall, the dynamism of investment in the last decade was based on capital goods imports. The emphasis here was on big companies, greenfield plants, and high technology.

(continued on page 3)

STRUCTURAL REFORM, INVESTMENT AND EMPLOYMENT: THE CASE OF BOLIVIA

Bolivia today is very different from a decade ago. The State has withdrawn from productive activities and now concentrates its investment in social sectors and basic infrastructure. The foreign-owned private sector heads gross capital formation, which has reached high rates and is geared mainly towards hydrocarbons and basic service industries. The domestic private sector invests primarily in agroindustry, with a view to export. The Bolivian economy is in transition to development, though it still faces serious pitfalls.

Since 1985, both production and the labour market have experienced the consequences of structural reform and stabilization policies. The adjustments entailed a change in conduct in all sectors, which in turn brought about modifications to the country’s productive structure and job supply, while the labour market was slow to adapt to the reforms and to liberalization.

The most important policy measures applied to the economy from 1985 were the relaxation of the exchange rate, a conservative fiscal
In our increasingly globalized world, smallness is an economic disadvantage, especially for developing countries. Although globalization and free trade present opportunities for overcoming restrictions associated with small market size, the distribution of benefits and costs of integration into the world economy is not always equitable, nor is it risk-free.

Countries in the region qualifying as “small” (under 10 million inhabitants at the beginning of the 1990s) include all the Caribbean except Cuba, the Central American isthmus, Bolivia, Paraguay and Uruguay. Some of these nations, particularly Small Island Developing States (SIDS), have populations below 300,000, which require special attention. On the positive side, these small countries have more to gain from globalization than larger countries do, since access to global markets allows them to overcome the limitations of their local ones. But they suffer major disadvantages relating to economies of scale, less diversification and small economic area.

The economic characteristics of small economies generate special risks. In particular, their level of openness, together with a rigid or highly concentrated export structure makes domestic income highly vulnerable to external shocks. As a group, small Latin American and Caribbean economies are much more open than their larger neighbours. The sum of their imports and exports of goods and services is equivalent to 85% of GDP, while in larger economies the proportion is 30%.

Moreover, exports from the region’s small countries are highly concentrated in a narrow range of products and markets, so they are heavily exposed to external price fluctuations and tend to suffer from higher income volatility than larger states.

In free trade agreements, small countries find it more difficult than larger ones to defend their interests at international forums, and they have problems using multilateral dispute settlement mechanisms established by the World Trade Organisation. They have a more limited capacity to comply with international commitments on environmental and property issues, as required by global integration.

Furthermore, in Latin America and particularly the Caribbean, smaller economies often have limited land and natural resources, and they are especially exposed to natural hazards, among them hurricanes, earthquakes, volcanic activity and overtaxed ecosystems. These disasters can easily affect nearly 100% of national territory and damage from a single event can exceed total annual government revenues. In addition, many SIDS in particular must also overcome difficulties associated with geographic and economic remoteness.

Helping small countries overcome these problems and successfully integrate into the global economy, which is a fundamental aim of free trade and globalization, requires consistent domestic and international attention. Some small countries should consider abandoning bilateral agreements in favour of multilateral approaches that better allow them to protect their common interests and use their scarce financial and human resources more wisely. They need to form public and private alliances on trade matters and general development programmes, adopt flexible, prudent macroeconomic policies, and take action to establish or strengthen institutions in charge of disaster preparedness.

At the international level, special treatment should be granted to small economies in multilateral trade agreements, involving longer transition periods to meet new policy demands, more flexibility in setting thresholds or defining legal and institutional obligations, more manoeuvring room for active production policies, broader safeguards, and the provision of technical assistance during the negotiation process and afterwards. The imposition of strict symmetry in commitments and trade reciprocity between countries of very different development levels may cause initiatives in this area to fail, ultimately affecting trade and development in small and large countries alike.

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machines and equipment, all of which are in line with the actions of multinational companies and economic conglomerates.

Other characteristics of this process were the high level of dependence on domestic demand as a motor of investment, and the ground lost by the manufacturing sector as an investment target in favour of non-tradeable goods sectors, especially infrastructure and public services.

However, manufacturing activities regained ground after 1995 as their technology was modernized and their move into exports consolidated. From then on, most investment went to industry, which became the driving force for progress in production.

In this process there is no defined pattern for the international positioning of industry. While some activities (dairy products, ceramics, flour and meal) have achieved such a position at competitive levels, others face serious size and technological constraints that are in turn backed up by some sectoral regulations.

**The Colombian Situation**

Although Colombia seemed to be one of the Latin American countries that had most successfully adopted the package of structural reforms, recent results are not those expected. Since 1996 economic growth has been below historical trends and in 1999 fell by 5%. Unemployment surpassed 20%. Such figures are unprecedented for the Colombian economy. It is too early to assess the effect of the reforms on medium and long term growth, but it is increasingly apparent that some policies were mutually inconsistent, particularly the substantial growth of public spending that accompanied economic growth.

Unemployment surpassed 20%. Such figures are unprecedented for the Colombian economy. It is too early to assess the effect of the reforms on medium and long term growth, but it is increasingly apparent that some policies were mutually inconsistent, particularly the substantial growth of public spending that accompanied economic growth.

In 1995, investment in Colombia exceeded 21% of GDP, the highest rate in twenty years. The investment boom was both public and private. Investment grew in infrastructure and public services, and fell in industry and agriculture. This reallocation of resources reflected the expansion of non-tradeable sectors and the contraction of tradable sectors. The growth of investment was made possible by the modification of the incentives system for the provision of goods and infrastructure services, as almost all sectors were opened up to private investment. Other influences on investment growth were the acceleration of economic growth in the first five years of the decade and the continuous revaluation of the real exchange rate.

Although the rate of investment in manufacturing industry did not increase substantially, it was higher than in the second half of the 1980s (4.0% in comparison to 3.5%), and did grow in a broad range of areas, particularly in industries intensive in natural resource processing. Those intensive in unskilled labor lagged behind, and have been the biggest losers in the process of opening up.

Between 1997 and 1999 the rate of investment again fell to the levels prevailing prior to the opening up. The economic contraction of 1999 is linked to the slump in private investment, which prompted a 6% reduction of output. This suggests that the Colombian economy faces difficulties in inducing sustained growth in its saving rates and in creating conditions for a steady increase in per capita income.

**Common Trends**

The structural economic reforms undertaken by Colombia and Argentina in the last ten years are relatively recent compared with those in countries such as Chile and Mexico, and as such are part of a process of continuity in investor thinking whose origins go back to earlier decades.

In both cases, the trends point to greater investment in infrastructure and a transfer to the private sector of activities traditionally carried out by the State. The basic framework for these changes was provided by one of the pillars of economic reform: the privatization of public companies that acted as a catalyst for investment projects.
Latin American and Caribbean countries have embarked on a new experiment in economic policy, leaving behind the import substitution industrialization model that had dominated the region since the middle of the last century. Country after country has introduced a new economic model (NEM) that emphasizes the free play of market forces both domestically and internationally. Proponents of this model had long argued that it was the only way to overcome the problems of inflation, balance of payments deficits, rising international debt, inefficiency and lack of international competitiveness that had plagued the region. The results of the NEM are, however, far from clear, and remain the subject of considerable debate.

Most of the assessment of the new model has taken place at the macroeconomic level, as noted within a special issue of *World Development* on the “Microeconomics of the New Economic Model in Latin America,” by this author and Nola Reinhardt Smith College. The contributions to this volume demonstrate that considerable adjustment processes are taking place at the microeconomic level. These processes have not, however, resulted in widespread shifts of resources between broad economic sectors, nor have they significantly improved aggregate growth, productivity and employment. The authors analyze the reasons for this mismatch, and suggest policy alternatives.

The proponents of the reforms that implemented the NEM expected that the new array of price signals would result in a transfer of resources into more efficient, internationally competitive activities, thus raising the overall level of production and income. The contributions to the volume document that more change has occurred in companies and within sectors than is apparent at the aggregate level. Efficiency gains have come about more through improved practices at the company level than through resource reallocation. This may, of course, be a result of lags between microeconomic responses and observed restructuring at the sectoral and macroeconomic levels, which remains to be seen.

The one exception to this picture of little structural change concerns to exports. Change in the export structure is most apparent in countries north of Panama, where the labor-intensive assembly plants (maquila) located in Mexico, Central America and the Caribbean have boomed in the last decade. In most South American countries, on the contrary, capital-intensive processing of natural resources increased their share in the export structure. The impact of the NEM on export dynamics has thus not been uniform across the region, as is shown by the dynamics of a structural change index for Latin American exports (see table). It has been strongly influenced not only by internal factors such as the previous level of industrial development and the existing resource endowments of each country, but also by external factors such as the country’s geographic position vis-a-vis the United States and its trade relations with that country.
We now know that export growth does not always lead to export-led growth. This is true even of some of the more successful exporters, such as Mexico, where overall economic growth in the 1990s has been moderate despite rapid export growth. In these cases, export growth based on specialization and use of imported inputs led to a relatively small share of domestic value-added, and an even smaller share of national inputs, in the total value of exports. As a consequence, the impact on the country’s overall production structure was slight.

The introduction of labour-saving techniques and the substitution of imported inputs and capital goods for domestic products resulted in productivity increases at the company level that supported rapid export growth. However, this was also accompanied by a reduction of local technological effort. The lack of emphasis on the development of technological capabilities is troubling from the perspective of the long-run dynamics of the NEM. For those countries relying on cost-based advantages deriving from natural resources or low-wage labor, global competition will make it difficult to maintain these advantages over time. Labour-intensive assembly industries are highly sensitive to changes in unit labour costs and market access, and are footloose, particularly in low-tech sectors like apparel. At the same time, most resource-based export sectors are technologically mature and quite vulnerable to cycles of boom and bust.

Economic concentration has increased in the fastest growing manufacturing and agricultural sectors. The most dynamic export-oriented sectors are not particularly labour intensive (natural-resource processing, automobiles), the main exception being the maquila plants. At the same time, large multinational corporations have increasingly dominated production or marketing in these dynamic sectors, while leaving domestic producers, particularly smaller ones, concentrated in the less dynamic domestically-oriented activities. This lower dynamism results from the negative effects of the NEM on domestic market demand, which the growth of exports has been insufficient to overcome except in a few countries. This pattern of microeconomic restructuring has resulted in very moderate overall employment growth, with most new employment concentrated in services.

The NEM has unleashed market forces in the region. A country’s ability to respond flexibly by moving into new areas of comparative advantage is key to its long-term success in the global economy. The manner in which the countries of the region have followed their static comparative advantage has troubling implications for their development.
The deepening of the reforms did initially prompt some investor uncertainty but, as they were implemented, investment returned to even higher rates of growth, reaching 17.36% in 1997.

**Labour Market**

Because of its effects on the labour market, it is important to keep in mind the demographic impact of increasing urbanization, especially the marked differences brought about between the growth of the rural and urban populations. While in 1985 some 51% of the population was rural and 49% urban, by 1996 some 60% lived in urban areas and just 40% in the countryside.

There was also an increase in the economically active population (EAP) in the capital cities, from 43.7% of the total city population in 1985 to 56.4% in 1996. This was repeated in the case of the female EAP, which grew by more than 18% between 1985 and 1996.

In the last decade, the labour market has responded flexibly. Urban unemployment fell to 3.5% of the EAP in 1996 and self-employment declined as a share of total employment, with a consequent increase in waged labour. Real urban wages grew by almost 40% between 1989 and 1996.

As a consequence of state withdrawal from economic activity, employment in the public sector contracted sharply, from 6.1% of the employed population in 1985 to 1% in 1996. Employment in the private sector, by contrast, increased by 13.9% in the same period.

Labour productivity, however, tended to fall throughout the period. This is explained by the lesser availability of capital per worker, a situation determined by the higher rate of participation in the labour market, greater investment efficiency and the growing informality of the economy.

It is worth highlighting the behaviour of employment in manufacturing industry, which accounts for around 10% of employment at the national level. Here, changes in production are linked to variations in productivity and have in turn helped bring about changes in employment levels and real wages in the sector.

**Shared Tasks**

Legislation in Bolivia is complex and contradictory, creating a climate of uncertainty and distortion in the labour market. Although there is consensus on the free market model and the reforms associated with it, this still needs to be translated into improvements for the whole population.

Investment in human capital thus seems to be an obvious priority for attaining development and improving living standards. The national private sector associated with foreign investment can contribute to achieving these by developing a competitive and profitable productive sector.

This article is a summary of three documents in the Reformas Económicas Series: N°33, Reformas, crecimiento, progreso técnico y empleo en Bolivia; N°38, Reformas, políticas sociales y equidad en Bolivia and N°42, Las reformas estructurales bolivianas y su impacto sobre inversiones.
The reforms adopted in Brazil during the 1990s substantially modified the economic scenario prevailing in the country during previous decades. Commercial and financial opening, social security reform, some administrative reform and the privatization of public companies are some of the most relevant changes. The reform process has been on such a scale that is too early to offer a final judgement. The 1990s, however, are already considered as a “decade of transition.”

Although there have been positive results, the general outcome at the end of the decade - especially as regards social indicators and the capacity to compete in the international market - is still less than could be desired. Some of the responsibility can be attributed to the particular nature of the price stabilization program, which defined the context of the structural reforms. On the one hand, ending inflation was an important step in securing the confidence of economic agents and, consequently, in winning the necessary political support for the reforms. It is no coincidence that the latter were intensified in the second half of the decade. On the other hand, the prolonged use of an over-valued exchange rate and high interest rates affected competitiveness and the trade balance, despite a substantial increase in productivity.

The Brazilian economy underwent a significant process of productive modernization, but capacity expanded comparatively little. Modernization was not reflected in a growth of exports to offset the increase in imports, nor could it create new jobs.

On the fiscal side, the increases in the tax take produced surpluses, but these have been insufficient to offset the cost imposed by high interest rates. The outcome in terms of fiscal disequilibrium has affected other items on the reform agenda, such as the privatization of public companies. In some cases, companies were sold before the affected sector was regulated.

It is important to consider the impact of the reforms in the social area, especially the changes in direction that have taken place in recent years. Prominent in this regard are the growing decentralization of spending by strata of the public administration and the incipient but growing participation of the private sector.

In the agricultural sector, the lack of official credit, associated with price stabilization, led to productivity increases, but negatively affected the trade balance and factors market.

Another element to be considered is the impact of the reforms on the system of productive innovation, since commercial opening and facilities for importing technology affected national technological capacity.

From another perspective, the transformations introduced during this decade of transition have also changed the profile of the employed workforce and the sectoral concentration of employment, although discussion of income distribution remains a recurrent theme in the economic history of the country.

The Brazilian experience is notable for the sequence adopted to implement the various reforms and, most particularly, for the peculiarity of a reform process carried out within a federative structure which is simultaneously involved in a process of integration with other countries in the region. These circumstances have imposed conditions unforeseen in the literature on reforms.

Among the lessons to be drawn from the case of Brazil in the 1990s is that when a signal is lacking to economic agents as to a recovery horizon for economic activity, the very sustainability of the reforms can be affected. It is also evident that, once under way, the reform process requires its own continuity, in order to avoid any reversal, with the high social costs that this may entail.

The challenge for this decade is to identify new approaches to the process of reforming the Brazilian economy.

The following table shows the sequence of reforms adopted in Brazil during the 1990s:

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Note: The asterisks indicate the approximate date of adoption of the main measures.

2. Gestión de cuencas y ríos vinculados con centros urbanos, by Axel Dourojeanni and Andrei Jouravlev. A review of the conflicts stemming from the use of water and basins to supply populations, and from changes in water courses caused by human settlements. Available from adourojeanni@eclac.cl and ajouravlev@eclac.cl.

3. Transformaciones recientes en el sector agropecuario brasileño. Lo que muestran los censos. (LC/G.2064-P, Spanish, US$25). Analysis of the main changes in the productive structure and in the use of the factors of production, especially labour and land, under the new macroeconomic conditions.


Part-time Work in Chile, by Sandra Leiva. Mujer y Desarrollo Series, N°26 (LC/L.1301-P, Spanish and English, US$10). Figures show 10% of total employment in Chile is part-time, more than half of it is female.

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