UPSAND DOWNS OF THE BRAZILIAN ECONOMY

The financial crisis which shook the world economy from mid-1997 hit Brazil badly, provoking severe recession and a stringent devaluation. Growth was only 0.2% in 1998 and fell 1% in the first quarter of 1999 compared with the same period the previous year.

Unemployment reached 7.6% in 1998 and 8% in March 1999.

The loss of international reserves was substantial, due to the country’s deep fiscal deficit and overvalued exchange rate, and the consequent vulnerability of its balance of payments to impact from abroad. Falling terms of trade and the sudden decline of capital flows to emerging economies made matters even worse. By mid-January this year the policy of gradual exchange-rate adjustment had become unsustainable and the real was devalued by 40%.

On the positive side, the reduction of the inflation rate to 2.5%, its lowest level in fifty years, was the most important achievement of 1998. Despite devaluation, prices rose only slightly, due to the recession and the fact that mechanisms for indexing the economy were not reinstated.

The other positive development, within the generally volatile situation facing the Brazilian economy, was the record inflow of foreign investment, due only in part to privatizations. This indicates that medium and long-term expectations for the economy, based on the structural transformations currently under way, are more hopeful than those for the short term, which depend on the consolidation of stability.

Government efforts during 1998 were aimed at containing the economy’s growing vulnerability, which sharpened in November 1997 and reached its worst moment in January 1999. Policy had to be adapted to fluctuating circumstances in which the external sector was the main factor.

SURPRISES IN STRUCTURAL REFORM INDEX

The past 25 years have seen a dramatic change in development policy in Latin America, as the region has moved away from State-directed industrialization and import substitution to liberalized, market-led models. But the process has been far from uniform from country to country, and it has taken a long time for consensus to be reached on exactly what should replace the old policy.

In a new study published by ECLAC, experts Samuel A. Morley, Roberto Machado and Stefano Pettinato assess the extent of reforms carried out so far and draw up detailed tables comparing developments in seventeen countries for the period 1970-1995. The purpose of the study is “to have some quantitative measure to help in determining the economic impact of the reforms”. In important respects the results are surprising. For example, by 1995, Chile, the quintessential early reformer, comes only seventh in the overall index. Instead, Uruguay appears as the most reformed country, followed by Argentina and El Salvador.

According to the report, Indexes of Structural Reform in Latin America, more than two decades of reforms have finally lead to consensus in the region over how the economy should work and the government’s role in economic management. The new model is based...
The attitude taken by Latin American governments to foreign direct investment (FDI) has changed radically since the 1960s. Efforts then were directed at substantially limiting the influence of FDI in local economies. Now countries allow foreign capital broad access, taking new initiatives to attract it and competing openly to obtain it. So, has the performance of FDI met expectations?

During the 1990s FDI flows into the region have grown on an unprecedented scale, from US$8 billion to almost US$67.3 billion, and the accumulated stock of such investment has increased by 60%. Of this inflow, the portion going to manufacturing is concentrated in countries with large domestic or export markets. Non-tradeable service activities have taken on greater importance within these massive overall flows of FDI, as has the exploitation of natural resources previously under State control, which has grown significantly. The purchase of existing assets is the method most used by foreign investors when both coming into the region and expanding their presence; such transfers of ownership accounted for almost two-thirds of FDI inflows in the past three years.

All these changes are reflected in the greater relative significance which transnational companies are beginning to acquire in Latin America. Between 1994 and 1997 among the 500 largest firms in the region, the share of sales by foreign companies grew from 29% to 33%. Even during the uncertain economic climate in 1998 and the beginning of 1999, the confidence of important foreign companies that their presence in the region will grow and be consolidated has continued.

In these circumstances, many analysts have pointed to a positive correlation between FDI and economic growth. The figures, however, do not appear to justify such a clear conclusion. Inflows in the 1990s were thirteen times higher than in the 1970s, but average growth was 50% less. Why, then, has this spectacular performance by FDI not had a greater impact on the region’s economic growth?

In the first place, most of this inflow resulted from the transfer of existing assets and did not mean the creation of new units of production. Its contribution to gross fixed capital formation has therefore been limited. Regional governments, meanwhile, under pressure from severe external imbalances, used FDI obtained through privatization to finance part of the balance of payments gap. At the same time, however, while these inflows did nothing to increase productive capacity in the receiving countries, they did bring improvements in services and thus in overall systemic competitiveness.

Secondly, insofar as national integration is concerned, FDI has made only a modest contribution to industrial development. Export models based on natural resources, or on industrial commodities derived from these, continue to reproduce existing enclave schemes. In the case of those based on the assembly of manufactures for export, the original regulations for access to the United States market virtually prohibits the use of inputs produced in the FDI-receiving country.

This gap between expectations and results raises new questions about FDI in Latin America. Governments need to define clearly both the priorities of their national policies and the role which they expect FDI to play. At the very least, the coincidence, or otherwise, of national policy objectives with the interests represented by such investment should be measured more transparently.

Governments need to define clearly both the priorities of their national policies and the role which they expect FDI to play.

Michael Mortimore is Officer-in-Charge of ECLAC’s Unit of Investment and Corporate Strategies. Special thanks to Álvaro Calderón for his help in preparing this column.
During its gradual stabilization process over the past four years, the Brazilian economy has made use of external resources to finance demand and import growth, and to allow increased consumption and investment. The current account deficit grew from less than 0.5% of GDP in 1994 to 4.5% in 1998, while the merchandise trade balance fell from a surplus of US$10.4 billion to a deficit of US$6.4 billion.

The Asian crisis substantially reduced the external resources available to countries such as Brazil. In the fourth quarter of 1997, the net flow of capital into the country shrank to less than US$1 billion, down from an average of US$8.3 billion in the three previous quarters.

As a result, severe adjustment measures were imposed at the end of 1997, including a restrictive monetary policy and the consequent rise of interest rates to annual levels above 40%. At the same time, a package of measures was announced to cut the public sector deficit.

The effect of this adjustment on the level of economic activity was felt in the fourth quarter of 1997 and the first of 1998. Industrial manufacturing, in particular, suffered an accumulated 5.5% fall in these two quarters.

From February 1998 onwards, capital flows began to return and international reserves were more than restored. The adjustment was gradually eased to soften recession, and the Central Bank’s interest rate, which had risen to an annual 40% at the end of October 1997, fell abruptly from March 1998.

But in August came the Russian crisis. Stock market responses were dramatic. Share prices plummeted on the São Paulo exchange, as did those of Brazilian bonds traded abroad. International reserves fell by US$24.4 billion in only two months.

Measures to deal with the crisis repeated those in November 1997. The Central Bank basic rate was raised, reaching 49%, and a new fiscal adjustment was announced. Nevertheless, capital flight continued, forcing even deeper adjustment and obliging the authorities to agree a recovery programme with the International Monetary Fund (IMF) and to seek finance in other countries.

A fundamental ingredient of the new fiscal package was the approval of constitutional reforms affecting public administration and social security. While these were not on the scale wanted by the government, they did allow measures to be put into effect to reduce the fiscal deficit.

In November, Brazil signed an agreement with the IMF, the World Bank, the Interamerican Development Bank (IDB) and several developed countries on a US$41 billion financial aid programme, to be used over three years.

However, turbulence increased at the beginning of 1999 when the State of Minas Gerais declared a moratorium on debt payments. Markets reacted immediately and the loss of reserves mounted dangerously. The flotation band was broadened in an attempt to contain the deterioration, but this was not enough to reduce the pressure. The Central Bank radically modified the exchange-rate regime, allowing the rate to float from 15 January. The strategy of gradual adjustments had proved unworkable in the external scenario created by the Russian crisis.

But from March 1999 the most negative expectations began to be reversed. The renegotiation of the November agreement with the IMF was especially important in this, as it allowed resources from the aid package to be used to stabilize the exchange market, making room for immediate intervention by the Central Bank. It also ratified the perception that the fiscal adjustment was genuinely under way.

Concern exists that the adjustments will turn out to be unsustainable in the medium term. There is evidence that improved net results for the first quarter were unduly influenced by one-off items of income, such as tax payments which were the subject of litigation, and pre-payments of concessions associated with the privatization of the Telebras (telecommunications) company.

The poor performance of exports, which continued to fall in the first four months of the year despite devaluation and a lower level of activity, is also cause for worry.
Many Latin American and Caribbean countries are currently in the process of changing their water laws and institutions. The exact nature of these reforms, as far as implementation, rate of progress and - most of all - precise content are concerned, varies considerably from country to country. Some countries have already introduced institutional changes, but the great majority are just beginning their reforms, after more than a decade of debate.

The main reasons behind this current wave of changes are:

- the desire to attract private-sector participation in public service provision;
- the hitherto inadequate use of economic and market instruments to improve resource allocation and use;
- the need for better management capacity to deal with growing competition for multiple water use;
- the growing problems of pollution and natural disasters.

As debate over this reform process has unfolded, Chile’s 1981 Water Code has come to play an especially important role as a model. In some countries, legislative proposals have copied this Code almost to the letter. But little mention is ever made of the problems which its application has created in Chile itself, especially its only partial success in fomenting the water market it was intended to achieve.

A comparison of the Chilean Code and the constitutional principles on which it is based, with the minimum basic principles that any water legislation should contain, reveals significant advances, but also a number of no less important gaps and limitations. For example, Article 24 of the country’s Constitution grants individual property rights to title holders. This is the only case in the region in which a country’s constitution lays down such a principle. Everywhere else, water is defined as a national good. In addition, the Code grants water rights-holders total and permanent freedom of use, allowing them to:

- use their water rights, or not to do so, for whatever purposes they please;
- transfer water rights separately from land, so they may be used at any location;
- buy and sell water rights through normal market negotiations.

Apart from the Chilean Code - and a few proposals for legislation in other countries inspired by it - no law in any country of the world grants water rights under such conditions.

The purposes of the most important regulatory mechanisms generally included in water legislation are to ensure efficient and beneficial use of the resource, protect

<table>
<thead>
<tr>
<th>Non-consumptive water rights in Chile</th>
<th>Being exercised</th>
<th>Established but not exercised</th>
<th>Application in process</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Principal hydroelectric companies</td>
<td>m³/s (%)</td>
<td>m³/s (%)</td>
<td>m³/s (%)</td>
<td>m³/s (%)</td>
</tr>
<tr>
<td>ENDESA</td>
<td>1 013 59.6</td>
<td>6 583 58.8</td>
<td>16 164 42.0</td>
<td>23 760 46.2</td>
</tr>
<tr>
<td>GENER</td>
<td>121 7.1</td>
<td>1 579 14.1</td>
<td>7 356 19.1</td>
<td>9 056 17.6</td>
</tr>
<tr>
<td>COLBUN</td>
<td>190 11.2</td>
<td>-</td>
<td>3 233 8.4</td>
<td>3 423 6.7</td>
</tr>
<tr>
<td>Subtotal</td>
<td>1 324 77.9</td>
<td>8 162 72.9</td>
<td>26 753 69.5</td>
<td>36 239 70.5</td>
</tr>
<tr>
<td>Other users</td>
<td>375 22.1</td>
<td>3 041 27.1</td>
<td>11 755 30.5</td>
<td>15 171 29.5</td>
</tr>
<tr>
<td>Total</td>
<td>1 699 100.0</td>
<td>11 203 100.0</td>
<td>38 508 100.0</td>
<td>51 410 100.0</td>
</tr>
</tbody>
</table>


N.B.: The country’s effectively exploitable hydroelectric resources are estimated at a maximum flow of approximately 30,000 m³/s, while the maximum economically feasible flow amounts to some 12,641 m³/s.

User rights subject to replacement.

Applications for water rights currently being processed include a substantial number of duplications which will make it unfeasible in some cases for such rights to be established and in others, the water rights that are the subject of competing applications will have to be awarded by auction. Some applications -especially the more recent ones- relate to resources of a marginal nature and lower technical and economic viability.
the quality and quantity of its sources, and prevent negative externalities being passed on to users. The Chilean Code not only contains no such measures but also applies uniformly throughout the country, without taking into account the varying availability of water in each region. Nor does it provide for water management entities to be created at river basin level. The weakness of the General Water Directorate makes matters worse, undermining both good resource management and the development of the water market which is the Code’s purpose to foment.

**New attitudes and areas of expertise**

The establishment of water markets demands new attitudes by public administration, the legal system and users, and requires them to become proficient in new areas of expertise. It also requires investment in adequate systems of administration, supervision, control and follow-up, of information about water resources and for registering and regularizing water rights. Improved methods of storing, distributing, transporting and measuring the resource may also be necessary. Putting a water-market system into operation without these prerequisites will provoke serious problems - social, environmental and economic conflicts among them. This is what is happening in the Chilean case.

The Chilean example shows the advisability of ensuring that water systems and management reflect the particular characteristics - whether physical, cultural, social, economic or ecological - of each region and its hydrographic basins. Similarly, water management should be understood as synonymous with the capacity to deal with conflicts between users and between these, the environment and the state. Management systems must be capable of preventing such conflicts or solving them when they arise. The water market, or any alternative method of allocating water resources efficiently for multiple use, will operate better when these basic conditions exist and are in harmony with the particular natures of the shared water systems.

**Goals for sustainable development**

Countries whose economies are based largely on exploiting natural resources need to invest larger shares of the income they earn from these resources in learning more about them and administrating them. Efforts aimed at improving research into natural resources and educating the population about them can help achieve the goals of sustainable development.

The most efficient allocation of water is achieved by conciliating interests and not through competition. There can be no doubt that the debate in Chile about the Water Code will benefit all users, so long as it rests on knowledge and balanced opinions.

---

The author is the Chief of ECLAC’s Natural Resources and Infrastructure Division.
on deep structural reforms in tariffs, taxes, the control of the international and external financial system, and, to a lesser extent, the role of State enterprise and labour regulation. The common purposes of these reforms are threefold: to open up the internal economy to foreign competition, cut back the role of government in allocating resources and directing production and reduce the distorting effects of the tax system on private decision making.

Unevenness of reforms

The authors, who focus on specifically structural rather than more general macroeconomic reforms, have created five indexes for trade, domestic and international finance, taxes and privatization. Each comprises a group of components chosen to reflect the degree of government control or, in the cases of taxes and tariffs, the degree of non-neutrality of the system. The authors emphasize that no value judgements are necessarily implied by these measurements, given that what may be considered optimal values will vary between the five areas. For example, “a complete absence of government control of capital inflows and outflows may well not be optimal”.

Taken as a whole, the indexes demonstrate the unevenness of the reform process in Latin America. Starting in the 1970s in the Southern Cone, the process halted and even reversed after the debt crisis of 1982-1985, spreading subsequently to the rest of the region. Trade reform and domestic financial liberalization were the first measures to be widely adopted, with eleven countries reaching a level of 85% of the most liberalized by 1990; by 1995 all but one had done so. There was also a very significant opening of capital accounts after 1990.

In trade, the largest and earliest changes came in tariffs and trade regimes, pioneered by Chile, Argentina and Uruguay, though the first two reintroduced import restrictions during the mid-decade crisis. By 1995 the average tariff in the region was 12%, compared with 45% in 1985, and no country - with the exception of Brazil and its automobile industry - was using its tariff system to protect or promote particular domestic sectors.

Financial reforms began in the 1970s in Colombia, Chile and Uruguay, getting under way in earnest after the crisis of the mid-1980s. Freed interest rates and the abandonment of direct credit were the two most widespread measures. By 1995 only Venezuela had controls on loan rates and none of the countries sampled still kept them on deposit rates. But regulation of the financial system - seen by ECLAC as an essential concomitant of liberalization - has not advanced at a similar rate, leading to a series of bank crises.

Consensus takes longer in some areas

Consensus over opening up internal financial markets to external capital took longer. Before the 1982 crisis, only Uruguay had taken major steps in this direction, to be followed at the end of the decade by a handful of countries, Argentina, Costa Rica and Guatemala among them. In the 1990s, many smaller economies followed suit, but Brazil, Mexico, Colombia and Chile still maintain significant controls as a defense against volatile short-term inflows.

There has been even less uniformity in the cases of tax reform and privatization. VAT (added value tax) was adopted in all countries by the 1980s and marginal tax rates on corporate and personal income, which significantly reduced the progressivity of income tax, have fallen. However, only seven countries reached the reform threshold set in the indexes, due probably to the conflicting goals of tax neutrality and social equity, as well as differences in the size of the government sector. Privatization has been widespread and much commented upon, but the index shows little overall change in the region.

This article is based on Indexes of Structural Reform in Latin America, No 12 in the ECLAC Series Reformas Económicas, by Samuel A Morley, Roberto Machado and Stefano Pettinato, LC/L.1166, 1999.
COMMUNITY MANAGEMENT IMPROVES RURAL EDUCATION

However poor they may be, rural communities still possess important resources enabling them to improve the education and health care they receive, and to take steps towards reducing poverty. Novel methods applied in both North and South America show that community management can be an effective weapon in increasing the quality of life in such areas.

ECLAC anthropologist John Durston recently compared experiences of such management in rural education in six countries, Brazil, Colombia, El Salvador, Guatemala, Mexico and the United States. The results, published in his study, _Gestión comunitaria de la escuela rural. Lecciones de seis experiencias internacionales_ (Community Management of Rural Schools. Lessons from Six International Experiences), showed that in each case the quality of education was improved.

**Personal codes and experiences**

Given the strong statistical association between the educational climate in the home and success at school, many educationalists explain the generally low level of educational achievement by children from poor rural backgrounds by pointing to a series of qualities lacking in their households.

In fact, says Durston, a high proportion of children at risk of failure at school suffer no especially debilitating limitations of knowledge. The problem is rather that their personal codes and experiences are different from those taken for granted by the school.

All six programmes discussed in the study came about as a result of motivational problems among teachers, which were found to be connected in turn to difficulties of communication and cooperation with parents and the community. Solutions to this vicious circle were sought by increasing community participation in decision-making, in the hope of renewing the teachers’ sense of mission and commitment.

The study describes two prerequisites for obtaining community support for autonomous school management. The first is that the school should be perceived as an educational unit involving teachers, administrative staff, pupils and the local community, and not just the Ministry of Education or teachers and the local authority. Secondly, the relationship between school and community should be understood as a process of negotiation resulting in a contract between the two.

**Two successful types of contract**

Two successful types of contract, formal and implied, emerged from these experiences. In both cases, civil society takes on a new role, and participation and motivation by teachers has been enhanced.

In the first type, teachers are hired by the community and paid out of state resources. Such contracts have legal weight, rather than merely confidence between parties. The community, or a committee representing it, interviews three candidates for each post of teacher or head teacher, and decides between them. The community also takes on the responsibility of guaranteeing the children’s attendance at school and that they will be given time and space at home for homework. Meetings are held with the teacher to deal with any problems, salaries are paid monthly and the contract is renewed if duties are performed satisfactorily.

The teacher, meanwhile, is responsible to the local community. The Ministry becomes a third party, whose responsibility is to vouch for the teacher’s qualifications, provide supervision and help in the relationship between teacher and community. In Mexico, the community pays the teacher a bonus for taking part in the programme, while in Guatemala it pays the whole salary.

The other type of contract consists in “team work” for a common end. This presupposes a stage of negotiation, in which goals, strategies and responsibilities are defined and the necessary confidence created between teacher and community. In the United States and Colombia, the latter does not choose the candidates nor handle salary payments; instead, it is the individual’s prestige and partnership in the social group into which he or she has been accepted which is at stake.

This article is based on _Gestión comunitaria de la escuela rural. Lecciones de seis experiencias internacionales_, by John Durston, ECLAC, LC/R.1883, 1999.

Revisión de los acuerdos sectoriales suscritos por países miembros del Mercado Común del Sur (Mercosur), LC/R.1880, Spanish. Reviews the four bilateral sectoral accords currently in force in Mercosur, and between Argentina and Brazil, and assesses the need to create new such accords in the future. Inquiries to: mizam@eclac.cl.

Gender Indicators, LC/L.1186, Spanish and English. A complete set of indicators for the measurement of progress and reverses in the situation of women in the region, to enable the follow-up of regional and international agreements aimed at achieving gender equality, especially the Regional Action Program 1995-2001 and the Beijing Action Platform. www

Un análisis del concesionamiento de autopistas urbanas, con referencia a los casos de la Costanera Norte de Santiago de Chile y del eje Javier Prado de Lima, Perú, LC/R.1879, Spanish. Analyzes these two projects as case studies of private-sector urban road concessions and presents a series of lessons drawn from these experiences for such tenders in the future. Inquiries to: ithomson@eclac.cl.

To order: Distribution Unit, ECLAC, Casilla 179-D, Santiago, Chile. Fax: (56-2) 210 - 2069. publications@eclac.cl www : available at the following websites: www.eclac.cl / www.eclac.org

To order: Distribution Unit, ECLAC, United Nations building, Av. Dag Hammarskjöld s/n, Vitacura, Santiago, Chile.