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ECONOMIC COMMISSION
FOR LATIN AMERICA AND
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The following symbols are used in tables in the Review:

(...)	Three dots indicate that data are not available or are not separately reported.
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(—)	A dash indicates that the amount is nil or negligible.
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	A blank space in a table means that the item in question is not applicable.
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(-)	A minus sign indicates a deficit or decrease, unless otherwise specified.
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(.)	A point is used to indicate decimals.
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(/)	A slash indicates a crop year or fiscal year, e.g., 1970/1971.
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(-)	Use of a hyphen between years, e.g., 1971-1973, indicates reference to the complete number of calendar years involved, including the beginning and end years.
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References to "tons" mean metric tons, and to "dollars", United States dollars, unless otherwise stated. Unless otherwise stated, references to annual rates of growth or variation signify compound annual rates. Individual figures and percentages in tables do not necessarily add up to the corresponding totals, because of rounding.

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Brazil: options *for the future*

Celso Furtado

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Creator of the Superintendency
for the Development of the
Northeast.*

*First Minister of Planning
of Brazil and also Minister
of Culture.*

*Now a Professor in the
University of Paris.*

This article analyses the present situation and future prospects of Brazil in the light of the globalization process. In the author's view, the market only generates globally coherent decisions in countries with a high degree of social homogeneity. Thus, the greater the social heterogeneity of a country, the greater the need for a national development policy. Such a policy should link up the concepts of globalization and social profitability on the economic and political level. Globalization furthers the destructuring of production systems in favour of companies that plan their investments on an international scale and promotes the concentration of political power, widening of the productivity gap, and the destructuring of cultures. Social profitability, on the other hand, has to do with the priorities of economic decision-making in national political systems and allows the values of the community as a whole to be taken into account. In a country of continental size, with great population mobility, the danger of disintegration of the national production system makes it hard to subordinate the channeling of investments to the rationale of the transnational corporations. If globalization is an unavoidable technological imperative, then the country has little room for taking its own decisions. The author concludes that in these circumstances countries like Brazil, with great natural resources and marked social disparities, may disintegrate or slither in the direction of fascist-type authoritarian regimes in response to the growing social tensions. In order to escape from this prospect it is necessary to return to the idea of a national project and make the domestic market once again the dynamic centre of the economy. The greatest difficulty is in reversing the tendency towards income concentration, which can only be done through a great social mobilization process.

I

Introduction

Conjecturing about the future configuration of the world economy is a mere intellectual exercise, because unpredictability is an inherent feature of capitalism. It may therefore be inferred that the concept of the long term has little analytical validity when dealing with the macro economy. A company of transnational scope would need to make long-term projections in order to render its investment decisions more effective, but this would not be appropriate in the case of a national economy.

Our aim here is to show that this line of reasoning is not consistent with an economy which is at a stage of development like that of Brazil, marked by pronounced structural and regional heterogeneity, because the market only generates globally coherent decisions in countries which have attained a high degree of social homogeneity. What is beyond doubt is that, if it is desired to raise the technological level, then the greater the degree of social heterogeneity, the more necessary it will be to have a guiding project for a national development policy. In extreme cases where the nation-state does not exist (colonial status), a development policy is not practicable, but this is not the case of the present so-called underdeveloped economies. The situation of such economies

is undoubtedly complex, however, since the dominant forces are generally heterogeneous, and this makes it more difficult to obtain a social consensus.

Consequently, it is essential to make a case by case analysis, since the changes in the international situation may have very different effects from one country to another. In the case of Brazil, there is a clear difference between the present situation of disastrous external overindebtedness and imbalances in the public accounts and the situation in, for example, the 1930s, when it was the dynamism of the domestic market which propelled the economic process and access to external finance was very limited.

There have undoubtedly been conditions in the past which made the application of a development policy possible and even inevitable: the dominant social forces were pressuring in that direction. Other circumstances, in contrast, may favour the emergence of charismatic and even populist leaders who can mobilize heterogeneous and even traditionally antagonistic social forces. It is not a question of accepting the theory of historical determinism, since the creative power of mankind can overcome any kind of constraint, but of identifying the factors that limit the exercise of that power.

II

Changes in the space available for political creativeness

I now propose to explore the changes which are taking place in the delimitation of the space available for political creativeness. There are two concepts which can help us to put our ideas on this complex matter in order: globalization and social profitability. The fact that it is necessary to link up the problems that arise on these two levels of analysis shows how complex this matter is. As a general principle, it is necessary to bear in mind the need to go beyond the limits of economic analysis and bring in factors of a

political nature. On both the national and the global levels, the economic variables are intrinsically linked with the power structures, and the political aspect becomes more difficult to grasp as its origin ceases to be the mere control of capital and spreads to the control of technological innovations.

Let us consider the globalization process. The importance of external trade for the growth of all economies has been recognized ever since the beginning of the Industrial Revolution. Ricardo's theory of

comparative advantages was the first consistent explanation of the development process promoted by the international division of labour. Protectionism, for its part, was simply a theory based on the positive effects of containing demand for the benefit of investments connected with the domestic market. One way or another, growth was propelled by economic policy decisions. The industrialization of Brazil is a classic case of growth induced externally through subsidies for the importation of equipment.

What is new in the case of the current globalization process is that it is taking place thanks to the destructuring of the existing production systems, which works to the benefit of the big corporations that plan their investments on an international scale. Thus, the motor industry which was installed in Brazil half a century ago as a function of the growth prospects of the domestic market has been restructured in the light of production processes in a multi-national space. From the point of view of the companies involved, this has obvious advantages, starting with the economies of scale in production obtained through the use of third-party suppliers. This strategy makes it possible to share with other companies the risks of possible losses due to the greater instability of effective demand on account of globalization.

Globalization considerably increases the power of the big corporations in their negotiations with the local authorities and, in particular, with their workers. This explains the decline in the power of the trade unions which may be observed all over the world and not only in the developing countries.

A key factor for weighing the future of the globalized civilization lies precisely in the fact that the dynamism, but also the instability, of the capitalist system resides in the control of accumulation by a minority which also exercises political control. It is the predominance of these forces that is responsible for the tendency towards income concentration and the crises of insufficient effective demand and structural unemployment. The power of workers' trade unions was able to grow because it played the important role of correcting the insufficiency of demand. In this sense, it may be said that the diffusion of political power brought about by the rise of the workers through unionization was of fundamental importance for the development of capitalist society. It may also be said that without this diffusion of political power capitalist society would have run out of steam in

terms of growth or would have taken the form of totalitarian regimes.

In order to understand the special nature of economic underdevelopment, it is necessary to look back at the evolution of the system of the international division of labour. The primary commodity exporting countries achieved increases in productivity simply through the reallocation of resources, thus differing structurally from the countries that benefited from increases in physical productivity through the introduction of new technologies.

This was how the productivity gap already referred to in the early studies by ECLAC arose. Underdevelopment is the stage occupied by those countries which have built up a serious lag on the technological level. Narrowing this gap has become increasingly difficult because the underdeveloped countries have become dependent on the importation of technological innovations. It has only been possible to reduce this gap in those countries which have managed to build up an autonomous technological system of their own: that is to say, countries where the concept of social profitability has prevailed in the allocation of investments. This leads us to conclude that underdevelopment can only be overcome through the adoption of a coherent set of public policies. The market rationale leads inexorably to the consolidation or widening of the gap, as shown by past experience.

The innovations which foster development are of a technical or an aesthetic nature. If we look at any product that symbolizes progress, such as the automobile, we see that its evolution curve is marked by phases where technical progress prevails and others where changes of an aesthetic nature are more evident. It can easily be seen that if innovations were limited to the technical level the market would soon be saturated, giving rise to an increase in wages and a drop in investment. The introduction of new models is essential in order to maintain the income distribution pattern. Consequently, it can be said that innovation originally based solely on technical progress has increased its efficacy as it also began to be based on mankind's capacity to invent new aesthetic values. Of course, aesthetic values can emerge quite independently of technical innovations or can be influenced by them, as we have long seen in the case of music. In short, aesthetic values, together with ethical values, reflect the most noble forms of human genius and require a form of protection that only

public policies integrated within a social development project can assure. Without this overall view, the technical dimension takes over completely and leads to a process of cultural destructuring.

The second of the two concepts that will help us to grasp the significance of the changes currently under way is that of social profitability. This concept relates to the ordering of economic decisions within the framework of national political systems. In its primary export phase, Brazil was a relatively closed economy, since exports accounted for barely a tenth of the national product, so that the domestic market was always a basic reference point for those responsible for taking economic decisions.

Obviously, the strategic decisions taken were conditioned by external factors connected with the balance of payments situation. Once this external pressure began to be relieved, however, which took place after the great crisis of 1929, the country embarked on a long growth phase based essentially on the domestic market. This growth gave rise to a production system designed to make selective use of the limited import capacity, backed up by strong protection of the areas with low levels of competitiveness. This policy undoubtedly helped to consolidate national unity, by creating a market reserve for regional production surpluses which lost their outside markets, and it stimulated subsidized investment in strategic activities, largely organized on the initiative of the State.

This nationally integrated production system had some special features linked with the history of a continent-sized country in the process of occupation of its territory and with great population mobility. There are only a few countries with these characteristics, and all of them, including the United States, which constitutes a special case, are relatively closed economies. Naturally, this kind of country has great growth potential if suitable policies are applied. In the case of a developing country, like Brazil, the main thing is to use the limited import capacity to absorb technology in the context of public policies which take due account of the special features of the country's stage of development.

If the strategic objective is to combine a high economic growth rate with the reduction of unemployment and of income concentration, then it must be acknowledged that the allocation of investments cannot be left subject to the rationale of the transnational corporations. It is necessary to start from the concept of social profitability in order to ensure that the substantive values embodying the interests of the community as a whole are taken into account. Only in a developed economy with a high degree of social homogeneity is it possible to rely on the market rationale for the allocation of strategic investments. The discrepancy between the market rationale and the interests of society tends to get worse with globalization. In the case of the motor industry, the problem seems simple, as the companies concerned are foreign-owned and technological progress involves an increase in their own foreign exchange costs. The same phenomenon may occur in the case of locally-owned companies, however, as more advanced technology likewise means an increase in their foreign exchange costs, but this leads to growing pressures on the balance of payments. Nevertheless, the main problem is not this, but the negative impact at the social level. The traditional technology on Fordist lines tends to be replaced by organization in work groups, in pursuit of **flexibility**, and this reduces the capacity of the workers to organize themselves in powerful trade unions. This problem presents itself most seriously in the most highly developed capitalist countries, especially the United States, and it lies at the root of the generalized tendency towards income concentration.

We thus arrive at the nub of the problem raised by technological progress. The line this is following reflects the need to diversify consumption in the countries with a high standard of living. Innovations in marketing techniques have taken on growing importance. The sophistication of the consumption patterns of the rich countries tends to be the force behind the evolution of technology. This is the only rational explanation for the frantic waste of goods thrown away on the grounds that they are obsolete, and the brutal assaults on the ecological frontier.

III

Some final reflections

We thus return to the ideas expressed at the beginning of this article, where we noted how unpredictable the evolution of the capitalist system is. Its dynamism is of a compulsive nature and leads to recurrent phases of tension with unforeseeable results. The tremendous destruction caused by war has made way for periods of extraordinary prosperity. Within this general context of uncertainty, we must try to gain an idea of the way that Brazil will go. If we accept the thesis that globalization is an inevitable technological imperative which will cause all economies to follow a process of unification of strategic decisions, then we must admit that this reduces the space for independent decisions. Brazil is a country which is marked by profound social disparities as well as inequalities between the levels of development of its various regions: in this sense it is a fragile member of a world dominated by transnational corporations that take advantage of such inequalities.

Globalization works to the benefit of those who are on the leading edge of technology and exploit the differences in levels of development between countries. This leads us to conclude that it is the countries with great natural resource potential but marked so-

cial disparities –the case of Brazil– which will suffer most from globalization, since they run the risk of falling apart or moving towards fascist-type authoritarian regimes in response to the growing social tensions. In order to escape from this danger we must return to the idea of a national project designed to make the domestic market once again the dynamic centre of the economy. The greatest difficulty in this is to reverse the process of income concentration, which can only be done through a great social mobilization process.

The new generation must be prepared to cope with great challenges, since on the one hand they will have to preserve the historical legacy of national unity, while on the other they will have to continue with the construction of a democratic society open to external relations. As the growth potential of the domestic market is great, there is room for positive collaboration by the technology controlled by foreign groups. To put it in a nutshell, we can say that Brazil will only survive as a nation if it develops into a juster society and maintains its political independence.

(Original: Portuguese)

Major macroeconomic *disturbances, expectations* and policy responses

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The episodes of great financial volatility and wide fluctuations in the level of activity of a number of economies have heightened the debate on how major macroeconomic fluctuations are generated and spread. Although it is acknowledged that much can be learned from the study of specific cases, in the literature decisions are often presented as though the agents adopting them were fully aware of all the relevant probability distributions. It is desirable, however, that in analysing these phenomena it should be recognized that both the economic agents and policy-makers are acting in variable contexts, with perceptions and expectations that change according to the inferences that each one draws from the evolution of the surrounding environment. In these conditions, the interpretation of fundamental variables such as the fiscal deficit or the current account balance is necessarily conditioned by conjectures about their future evolution: it cannot be maintained, then, that the state of the “fundamentals” is directly observable. The changing perceptions of the agents can thus result in big fluctuations in expenditure and credit conditions. This article addresses the problems of expectations which can give rise to failures in the coordination of intertemporal plans and considers policies which could prevent or reduce such upsets; analyses, with regard to fiscal matters, the evaluation by the public sector of its budgetary constraints over time and the possible application of counter-cyclical measures; reviews the alternatives open in terms of the choice of exchange-rate systems in economies with different characteristics (especially the greater or lesser use of foreign currencies as denominators in contracts) and the design of financial policies; briefly refers to the international transmission of macroeconomic impulses, and finally offers some conclusions.

I

Introduction

The recent episodes of great financial volatility and big swings in the level of activity which have been observed in a number of economies have intensified the debate on how major macroeconomic impulses are generated and spread. These phenomena seem to have a special nature, different from that of "small" economic cycles: they cause concern because they can give rise to considerable real costs and they may be associated with discontinuities in the growth path. From the point of view of policy formulation, the experiences of recent years have made economists ask themselves what instruments could serve to make major fluctuations less likely and to improve the "crisis management" measures that might be needed to deal with them. This article seeks to make some contribution to the analysis of these issues.

The analytical approaches taken to study macroeconomic fluctuations marked by credit crises have changed over the course of time. At one time, such fluctuations were considered to be inherent in the evolution of the economic system. Later on, macroeconomic analysis tended to leave them aside, considering them as anomalies that were associated with particular individual economies and were due to visible policy inconsistencies. Recent experience, however, suggests that although there is no reason why such crises should recur systematically, they can affect very different economies and regions and even the international system as a whole.

The events of recent years have had various novel aspects as regards the mechanisms behind the generation of financial disturbances and the patterns of propagation of impulses between economies, al-

though they have also had traditional elements too.¹ It is generally acknowledged that much remains to be learned about these processes and that it would be useful to explore the lessons that could be drawn from the different experiences in this field. The point of view taken in the present article is that this attitude should be incorporated into the analysis itself, because it has very concrete implications: it is important to bear in mind that the decisions of the economic agents and policy-makers are made in contexts where perceptions and expectations change according to the inferences that each one draws from the evolution of the relevant environment. In these conditions, it is hard to imagine that, in establishing their plans, the actors have a complete and finished model of the working of the economy before them. Something similar occurs in the case of an analyst studying macroeconomic disturbances: in view of the type of phenomenon being studied, the conclusions drawn and the possible recommendations made will necessarily be of a tentative nature.

In the following section (section II), some comments are made on the relation between the fundamental variables and expectations. This question, about which a great deal has been written, is of central importance for interpreting major fluctuations in expenditure and in credit conditions. Section III deals with economic policy issues associated with the prevention and management of major upsets, and finally section IV contains some comments on the international transmission of macroeconomic impulses.

□ The author wishes to thank E. Noya, B. Kosacoff and R. Martínez for their valuable comments. A preliminary version of this study was presented in January 1999 at the Eleventh Regional Seminar on Fiscal Policy. The author naturally bears sole responsibility for the views expressed in this article, as well as for any possible errors.

¹ Thus, some analogies could be drawn with the "trade crises" of the past, such as those analysed, for example, by Bagehot (1858 and 1873). The existence of such analogies and of questions which have remained unanswered for a very long time shows the complexity of the problems involved in the analysis of such fluctuations. At the same time, the fact that there are examples of crises which have occurred in very different conditions and times would seem to indicate that the fluctuations probably have their origin in general aspects of credit supply and demand decisions rather than in particular details of financial technology, although the latter would of course help to determine the particular features of each episode.

II

Fundamental variables and expectations

A sharp distinction is usually drawn between changes in the state of the economy due to movements in the fundamental variables and changes arising from phenomena of coordination of expectations –of the type of self-fulfilling prophecies– in situations with multiple equilibria. It is thus assumed in advance that such variables are objectively definable (subject only to the availability of sufficiently complete and up-to-date information), and it is also assumed that the expectations are always and necessarily consistent with each other, even though the resulting macroeconomic states are not always the best ones compatible with the basic variables.

This distinction is not really as clear as it might seem at first sight, however. When studying the evolution of fiscal policy, for example, the deficit in a given period does not provide sufficient information to determine the sustainability of the government's financial management. It is therefore suggested that indicators should be used which include corrections as a function of the state of the economic cycle or the variation in contingent public sector debts (see ECLAC, 1998a). In order to make such corrections, however, it is necessary to formulate some hypotheses on discrimination between cycles and trends in economic activity or on the size of undocumented public sector commitments, for which purpose it is also necessary to make some conjectures about the future behaviour of the economy.² This point is of a general nature. For example, the interpretation of balance of payments current account results depends on how one assesses such aspects as the growth potential of the economy, the return on the investments being made, or the consistency of consumers' expenditure and indebtedness decisions: in other words, in

order to make this interpretation it is necessary to place current behaviour in the context of the expected evolution of the opportunities for generating income (Heymann, 1994). Likewise, the valuation of assets is naturally a function of the perceptions regarding future movements of dividend flows.

Clearly, the fundamental variables do not relate to data at a given moment but to time sequences which must be projected one way or another. Of course, if it is assumed that the processes generating the relevant variables are known, then the projection is automatically formulated on the basis of past observations. In these conditions, "there is nothing new to learn": all the relevant information has already been incorporated in the model on which the expectations are based, and it is known for sure that this model will not be changed, because there are no new inferences to be drawn from the data. The future path of the system would thus be determined by "intrinsically" random disturbances which cannot be represented except in terms of their probability distribution, which is known.³

These hypotheses may be a useful approach for a variety of purposes, and it is possible of course that, when dealing with long periods, the past trajectory of an economy can serve for the extrapolation, without too much error, of regularities which have already been incorporated in the schemes of formation of expectations. The validity of such hypotheses is by no means as clear, however, for studying events such as crises, when it is observed that not only are the plans of the agents upset, but also the prior interpretations of the events seem to be generally questioned and there is a feverish search for the "lessons of experience". In other words, these fluctuations

² With regard to the trend-cycle breakdown, it should be borne in mind that the usual filters determine the trend at a particular point in time, using data subsequent to that moment. A recursive estimate, using only information observed up to the current period, may be appreciably different from the "definitive" calculation. This suggests that –for example, when assessing whether a particular form of behaviour has been pro-cyclical or counter-cyclical– a distinction should be made between a retrospective judgement and one based on the knowledge available when the decisions were taken.

³ It might be useful here to note the distinction, from the point of view of the formation of expectations, between exogenous impulses and those of international origin. The former refer to variables whose evolution is left out of the analysis in the model defining the predictions; the latter include variables due to the actions of agents who do not reside within the economy but, in principle, can nevertheless be represented in order to project the behaviour of the economic environment, just as an individual agent would try to find ways of anticipating the behaviour of other agents with whom he interacts.

seem to correspond to cases of transition in economies whose configuration is changing and in which past patterns of behaviour do not seem to form a sound basis for making predictions.⁴

In situations like these, identification of the fundamental variables ceases to be accurate, both for analysts and for decision-makers. It is not just a question of the greater or lesser availability of data: the lack of accuracy is due to the fact that there is no clearly defined manner of processing the information which will ensure the optimal nature of the expectations generated. In particular, in some cases it is especially difficult to project output and income trends: the changes which take place in the corresponding perceptions as individuals go through their learning processes⁵ can lead to cycles in estimates of wealth and expenditure capacity and in the valuation of assets (Heymann and Sanguinetti, 1998a and b).

When there are no firm bases for projecting future opportunities, decisions and interpretations of observed behaviour are necessarily of a speculative nature, not only because the plans made at a given moment are contingent upon uncertain future events, but also because, for each agent, those plans represent a wager on a particular way of forming expectations, and furthermore their outcome depends on how other individuals make their forecasts and revise them over time. This is also true of economic policy

⁴ This is a traditional problem: as Walter Bagehot pointed out many years ago, "in many cases crises cannot be attributed beyond reasonable doubt to causes which are known to be real, so that although the problem is clearly visible it is not possible to explain its causes with concrete facts and figures. The circumstances of trade crises differ so much that it is not easy to find a mechanism that can be applied to all of them" (Bagehot, 1858). Some recent studies have acknowledged that, in macroeconomic analysis, it should be borne in mind that data-generating processes can change in an unpredictable manner: as Calvo (1998) points out; "statisticians have the instruments needed to give us an estimate of how shocks are broken down as between permanent and transitory phenomena, but in order to do this it is necessary to make some very strong assumptions, in particular that the present does not differ significantly from the past. However, this assumption is questionable with regard to emerging markets". Moreover, in recent times greater attention has been paid to the statistical properties of series such as those on the returns on assets, which seem to display appreciable discrepancies with the normal distributions, so that a larger proportion of probabilities are at "extreme" values (see, for example, Lo, 1997).

⁵ There has been a good deal of discussion in the recent literature about models designed to represent learning processes in economic contexts. See, for example, Sargent (1993), Kirman and Salmon (1995) and Evans and Honkapohja (1998).

measures, regardless of the scope of their objectives: in particular, all policies which aim to take account of the government's capacity to generate income over time and the credit conditions it will be facing must also take into account the future evolution of the state of the economy and the perceptions of the various groups of agents. The complexity of public and private decisions is not always obvious, but it becomes very clear at times of crisis.

It may be gathered from the foregoing arguments that, if we accept that there is no sure and universally applicable model for the formation of expectations, then changes in the perceptions about the fundamental variables will play a potentially important role in certain fluctuating circumstances, and such perceptions are a matter of individual opinion.⁶ The formation of expectations will be particularly difficult in periods of transition, when, for example, there are signs of possible speeding-up of income trends which can give rise to upward revisions of investment and consumption opportunities, or when there are fears of an abrupt downward shift. Errors of expectations which have macroeconomic effects will be more frequent in such periods. At the same time, insofar as agents perceive the fragility of their prediction schemes, there will be "flexibility preference" effects: individuals will be reluctant to take positions perceived as being hard to reverse (Hicks, 1974; Dixit and Pindyck, 1994); also, imitative forms of conduct associated with possible "herd behaviour" will begin to assume importance (see Banerjee, 1992).

Reviews of expectations about fundamental variables can thus become a source of macroeconomic fluctuations. A substantial proportion of recent analyses have noted another possibility: that of "self-fulfilling prophecies" in systems that allow of a number of equilibrium paths, whereby the economy can be led to collectively undesirable states, because of the conduct of the other agents, even if each agent

⁶ From this standpoint, when we refer for example to the "fundamental valuation" of given assets we should perhaps add (even if only implicitly) the awkward phrase "according to the analytical model of the agent making the valuation". This point is of practical relevance. Thus, for example, the concern expressed by the Federal Reserve Board of the United States about share prices (see for example Greenspan, 1997) was connected with doubts about the way assets were valued and, indirectly, doubts about the validity of the growth projections for enterprise earnings underlying the demand for securities.

acts optimally.⁷ Although there can undeniably be interaction among individual expectations, one may wonder about the validity of arguments that attribute crises simply to a (socially) “bad” equilibrium selection. In models on self-fulfilling prophecies, the result is sub-optimal but the individual decisions are fully compatible with each other: all the agents know the path that the system will follow, and act accordingly. There is therefore no doubt about how the economy operates, which contrasts with the marked uncertainty that seems to prevail in such episodes. Quite apart from the foregoing, however, there are queries about how expectations are focussed on a given path and about the options open to economic policy for dealing with situations of self-generated runs, if these are the only disturbing element.

It might be useful to consider a specific case, such as for example a situation where the government has a mass of short-term debt which it has been refinancing. In order to focus on the logic of the argument, let us assume that in the hypothetical economy in question it is common knowledge (i.e., there are well-founded and unanimous expectations, also unanimously seen as such) that the government can service the debt, and has incentives to do so, if it continues to be refinanced. In other words, there are no “fundamental problems” that affect the government’s financial position. There will thus be a good equilibrium in which each asset-holder, anticipating that all the others will be willing to keep on lending, will consider that the best policy for him is to do the same and buy bonds once again when they mature. Consequently, there are no disturbances and no inducement for policy changes. If the level of indebtedness is sufficiently high, however, there may also be another type of equilibrium in which the collective expectation is that the creditors will refuse to re-finance the debt;⁸ if there is a stampede the

government will not be able to generate the resources to rescue the debt, so that its obligations will be paid off at a discount (either explicitly, or through a rise in prices, if the debt is in local currency), thus confirming the initial pessimistic forecasts. In this case, there is a self-fulfilling prophecy of a policy turnaround which is entirely the result of the formation of expectations, since such a turnaround would not occur in the case of the other possible equilibrium.

Obviously, the costs assumed by the agents in the bad equilibrium could potentially be avoided: what is needed is to coordinate decisions properly. In the foregoing example, the government does in principle have the means to do this. If, in the event of signs of a stampede, it decides to pay off the maturing bonds with other securities offering similar yields, then everything would take place (according to the hypotheses of this exercise) as if the government had persuaded asset-holders to “select the right equilibrium”, thus bringing the system to an optimum state. In this situation, there is no need for a fiscal adjustment, or discounting of the debt, or upward leaps in price levels, because there is no fundamental reason calling for this. At the same time, from the standpoint of the private agents, although the refinancing of the debt would force each of them to carry out an action which would be different from that which they would have chosen in the stampede equilibrium, it would not cause losses:⁹ on the contrary, according to the assumptions of the example, this measure would lead to a state which was preferable for all the individuals in question (or at least no worse) compared with the situation that would exist if such a measure were not taken. In the hypothetical

rational. At all events, the respective probabilities perceived by individuals could depend in turn on the predictions regarding the economic policy responses in terms of the coordination of expectations (see the analysis of this matter later on in this article).

⁹ This conclusion is a consequence of the hypotheses of the example, which ignore the possibility that some agents might assign great importance to the fact of having immediate availability of their funds (for example, if they had planned to concentrate their expenditure on the moment of maturity of the assets and they had no other possibilities of gaining access to liquid resources). At all events, the argument is not substantially modified by the incorporation of this effect if it can be assumed that the number of agents in this situation is known approximately, even though there is no information allowing them to be individually identified (see Diamond and Dybvig, 1983).

⁷ With regard to matters such as the generation of bank runs and the refinancing of the public debt, see for example Calvo, 1988, and Sachs, Tornell and Velasco, 1996. Diamond and Dybvig (1983), for their part, present a bank run model and analyse policy issues connected with those mentioned in the following paragraph of this article.

⁸ Determining the probability to be assigned to the different possible states is a delicate matter in arguments on multiple equilibria. Here, in order to simplify the argument, it is assumed that the possibility of a panic was not incorporated in the predictions, although this is close to being a contradiction if it is desired to represent the expectations of the agents as

case of the exercise, there would therefore be no reason why the refinancing should cause loss of prestige by the government.

The foregoing analysis seems to suggest that if a crisis occurs as the result of self-fulfilling prophecies, this could be because the government does not act (although capable of doing so) in a manner which serves to coordinate the agents' plans in the direction of a better state in which the predictions are also fulfilled. If the idea that crises can be prevented relatively easily seems at first sight rather implausible, this is not due to a flaw in the argument as such but to the hypotheses on which it is based, especially the assumption that the attack on certain assets could take place even in the absence of any uncertainty over the fundamental values determining the debtors' creditworthiness. In practice, expectation coordination phenomena often seem to take on importance precisely when there are doubts over repayment capacity (for example, it is hard to imagine a run on deposits if there are no indications of problems in the banks' portfolios). This does not mean, of course, that the assessments of repayment capacity are necessarily homogeneous and correct. On the other hand, "liquidity crises" can have powerful real effects by forcing the liquidation of assets and a contraction in credit (see Kiyotaki and Moore, 1997),

which has repercussions in turn on the wealth of the agents and hence their creditworthiness.

Various types of financial crises which have repercussions on real activity may be distinguished (see Calvo, 1995, and Leijonhufvud, 1998). In the case of the phenomena of interest to us (associated with events such as the Latin American crises of the early 1980s or the more recent macroeconomic upsets in Asia and Latin America), there have been big changes in perceptions of the creditworthiness of the public sector or major segments of the private sector, as well as sharp oscillations in the supply of credit and the capacity to finance the demand for goods. A feature shared by various cases is that they displayed big movements in the estimations of wealth, reflected in expenditure decisions and the valuation of assets. It is also clear that fluctuations are amplified and spread through variations in the severity of liquidity constraints. In other words, in these cases the effects originating in changes in the forecasts about the fundamental variables, in contagion of expectations and in fluctuations in liquidity conditions mingle in such a way that they confront private agents and policy makers with complex challenges as regards the identification of signals and the taking of decisions. The following section focuses on matters relating to economic policy management.

III

Economic policy responses to major disturbances

In the view of the foregoing analysis, credit crises can be associated with downward revisions of the wealth perceptions of macroeconomically significant agents, the effects of which spread through secondary impacts on income and wealth and the tightening of liquidity constraints. In these episodes, many agents must suffer losses and reduce expenditure in order to adapt to their intertemporal budgetary restrictions. It is possible, however, that there may be over-adjustments due to the excessive volatility of expectations and illiquidity effects. In cases of major disturbances, amplification mechanisms probably enter into action which multiply the cost of the original disturbance. From the standpoint of policy manage-

ment, it is important that the necessary adjustments should be made, but it is also important that unnecessary contractions should be avoided. Crises are periods of great uncertainty in which it is by no means a simple matter to determine the sustainable levels of income and expenditure of economic units and groups of agents. In these conditions, policy decisions can hardly be approached on the basis of mechanical criteria, without taking into account the state of the economy and the public sector's capacity for action. These difficulties highlight the value of safeguard measures.

The management of economic policy over time raises various queries about the incentives that guide

decisions at given moments and the way in which policy design incorporates the possibility that "unexpected" circumstances may arise and determines the action that should be taken when this happens. The comments made in this section will deal primarily with the latter type of questions. It is clear from the start that any idea of defining strategies that are optimal for any set of contingencies is not realistic. This would be tantamount to trying to programme generic actions in advance, which would call for unattainable levels of knowledge on the operation of the system and the shocks that could occur over time. Consequently, if we acknowledge the difficulty of identifying rigorously fixed criteria which do not admit any exceptions,¹⁰ what we must do is to seek approaches that take account of the learning process effected in analytical work and the observation of concrete experience. Furthermore, the problem of the prevention and management of major disturbances has special features, since it concerns phenomena whose probability and specific details cannot be accurately known in advance, because they are relatively infrequent and are usually associated with more or less rapid changes in the configuration of the economies in question. This particularly affects the assessment of the costs and benefits of preventive measures: quite apart from the "subjective" nature of the attitudes towards risks it is difficult to define with numerical precision probability distributions of events of different types and intensities that could serve as the basis for more precise calculations. At all events, in recent times we have seen that there is a by no means negligible potential for macroeconomic instability, and economic policies should naturally be formulated in the light of this fact.

¹⁰ Once again, this is a traditional issue in macroeconomic discussions. Thus, when commenting on proposals to add an "elastic clause" to the monetary system of his time (that is to say, an "escape clause" that would add a pre-specified contingent element to the prevailing rules), Bagehot (1858) takes the view that "the essential principle is that at a certain point in trade crises the directors of the bank and/or the government should be empowered to authorize an additional issue of banknotes, suitably backed by securities". He considers that the need for such a faculty can hardly be questioned, although there are many great difficulties in determining exactly how it should be granted. In contrast, he considered that the "elastic clause" seemed a more artificial expedient, concluding that the whole matter was a question of "choosing between different types of difficulties".

1. Fiscal policy

It is a well known fact that disorder in the public finances involves heavy economic costs. When the public sector is unable to handle the demands for expenditure within the constraints imposed by its capacity to generate resources, it lacks the means to define systematic policies. High and changing rates of inflation, possibly interrupted by occasional but transitory attempts at stabilization, are a typical symptom of such situations. Quite apart from the distortions that the inflation tax generates in itself, inconsistency in fiscal matters generates instability in policies too, since the government is forced to act as a function of the pressures of the moment. The resulting volatility complicates decisions and narrows the agents' horizon for planning ahead. The consequences are clearly visible in economic performance, especially in the credit markets, because the parties to a possible contract cannot predict their future situation except in the short term. This further heightens the liquidity constraints, not only for the government but also for broad groups of private agents. In order to overcome these situations, it is essential to take measures to restore the creditworthiness of the public sector.

As already noted, creditworthiness is a prospective notion. At all events, experience suggests that perceptions of the soundness of the government finances over time gradually change as a function of its observed behaviour: a history of instability can affect the public sector's access to credit for a long time. Especially in the case of economies which are facing a change in their fiscal system, there will probably be some tension between the incentive to give signals of financial soundness and the search for areas of action that can help soften macroeconomic impacts.

In analysing fiscal policy as a macroeconomic instrument, it is impossible to leave out the situation of the public sector and the state of the economy. It may be said that the considerable changes that have taken place in views on the role of such policy are partly due to the fact that the typical cases to which the analyses refer have been changing. In studies written after the 1930s depression, emphasis was placed on the counter-cyclical effect that such policy could have on aggregate demand and the desirability of easing fiscal policy in recessions. The argument was that the creditworthiness of the public sector was not in question (so that the government would have

no difficulty in financing possible deficits, which the public would see as transitory phenomena) and there were situations of insufficient effective demand in which it was difficult for the private sector to coordinate a level of expansion which would lead to "normal" use of the available resources. Now, however, many proposals take a markedly different attitude: that there is no reason why fiscal policy should seek to affect the level of activity and that, in any case, the best contribution it could make in this sense is to avoid a situation where public indebtedness exerts pressure on the credit markets: in the event of an adverse shock priority should be given to adjusting policies to maintain a low public deficit.

In view of these clear discrepancies, it might be useful to imagine two extreme situations resulting from a shock which reduces activity. In the first, possible suppliers of credit perceive the government as being in a fragile creditworthiness position. In this scenario, it is assumed that these perceptions are highly influenced by the short-term evolution of fiscal policy, either because it is expected that the disturbance will have lasting effects on public sector income or because creditors appraise the fiscal attitude of the government as a function of its immediate behaviour. Any attempt to issue new debt would hence raise growing doubts about repayment possibilities. Not only would the harder credit conditions affect the public sector but the uncertainty over fiscal policy would also affect the private sector's capacity to finance expenditure. In any event, the budgetary constraints on the government would be such as to make fiscal adjustment the only option (which does not mean that it would not also be costly), unless the government resorted to the even more costly expedient of inflation. In the second situation, aggregate expenditure is reduced for some reason and doubts arise about the solvency of a significant part of the private sector; the recession spreads through the hardening of credit conditions and the fall in employment. If the government is seen as being creditworthy, the "flight to quality" in the demand for assets may possibly increase the propensity of individuals who have funds to hold public securities. In these circumstances, a large number of agents will be facing serious liquidity constraints and, at the same time, the government can take out debt at a low cost. Thus, expansionary fiscal policy operations would be possible which, by increasing the resources available to the agents suffering from a shortage of liquidity, would help to secure a recovery in aggregate demand

and thus improve the opportunities of individuals as a whole¹¹ (Leijonhufvud, 1973).

This argument is applicable to cases of pronounced contraction, and differs from the traditional analyses as regards the management of fiscal policy over time on the basis of "representative agent" constructs (Lucas, 1986). There are also some general points of contact, however: a form of fiscal management which seeks to improve the possibilities for agents managing production and consumption over time should be based on an appraisal of the type and persistence of the shocks observed. This means examining projections of the future conditions of the economy. There is also a certain similarity between the two cases referred to in the previous paragraph. In the first case, the liquidity problems primarily affect the public sector; in the second, they affect a large group of private agents: what is needed is to channel resources from the less constrained sector to the more constrained sector, through an adjustment which reduces the deficit, or through measures which increase the spending capacity of the illiquid units, as appropriate. One thing is clear: in order for the government to be able to embark on this latter type of fiscal operations designed to soften the impact of the disturbances on the private sector, it must have a sound level of creditworthiness.

In practice, the government's scope for action depends on the state of the economy. Major disturbances in aggregate expenditure and the level of production not only affect the capacity to collect taxes but can also abruptly increase the public debt, explicitly or not (rescue operations for the financial system are a typical example of this). This means that, even from the restricted standpoint of looking after the public finances, it is important to limit the size of recessions. On the other hand, however, it is possible

¹¹ It is well known that when there are liquidity constraints, the Ricardian equivalence proposition does not hold; that is, these operations would be effective even when there is a clear perception that the increased public debt will generate a rise in future taxes. It should be noted that in a situation like that described here there are big differences between the implicit discount rates of different individuals: one group possesses liquid resources and is willing to lend at a low rate if there is no risk, but finds it difficult to identify creditworthy potential debtors, while the other group has a strong preference for current expenditure, since its opportunities are limited by current income, which is comparatively low. Thus, the action of fiscal policy may be equated with that of establishing a financial intermediation channel between the two groups.

that situations may arise where strong restrictions on private sector activity may be combined with difficult access to credit on the part of the government, if the latter is unable to make it clear that it can make up for present deficits with greater generation of funds in the future. Such cases raise particularly complex problems of fiscal policy decision-making because of the combination of opposing demands: complying with the budgetary constraints and preserving what is left of public credit, avoiding an over-adjustment in the provision of services, softening the impact on private expenditure and probably also taking care of distributive tensions, which may increase.

The possibility that conditions of this type may arise highlights the importance of preventive measures. There is general consensus on the desirability of practising counter-cyclical fiscal management. Maintaining a certain amount of leeway in the public finances when the economy is operating normally is particularly useful when the possibility that the private sector could be a source of instability is not completely ruled out. Such leeway can take various specific forms, such as the accumulation of liquid funds (or the implementation of contingent financing mechanisms which make it easier to gain access to funds when needed), but at all events it would appear to require a degree of "taxation capacity" previously unused in periods of expansion which could serve as backing for credit if some event which has an impact on the economy occurs. As is usually the case with insurance mechanisms, preventive policies are not without their costs, but the dangers involved in fiscal fragility have been amply demonstrated. At the same time, however, the idea that fiscal management should include elements to protect against the possibility of negative shocks still leaves open the question of how to identify trends in the evolution of the economy: one form of caution in this respect could be to avoid over-hasty extrapolation into the future of signs of strong growth¹² and to take action if it is seen that the private sector is taking decisions on the basis of exaggerated projections.

¹² In this respect, mention may be made of Talvi's argument (Talvi, 1996) on the interpretation of the fiscal results in the case of the demand booms which usually accompany some stabilization programmes: the problem here is confusion of a sudden transitory rise in revenue with a permanent one, the difficulty being that it is not easy to distinguish between the two kinds of shocks in transitional periods.

2. Financial policies and exchange rate regimes

The debate on financial policies leaves little room for simplistic positions. It is difficult to give general validity either to the arguments that the public sector can and should control the assets markets in detail or to those that assume that, in the absence of distorting interventions, those markets have self-regulating properties which automatically guarantee their proper overall functioning. Obviously, credit conditions sometimes show great instability, and in such cases economic policy should take action in one way or another: there are a number of examples of large-scale interventions (with heavy fiscal costs) which contradicted previous announcements that the government would not interfere (Vaz, 1999). At the same time, however, identifying mechanisms that will ease the smooth evolution of financial transactions and reduce instability is no simple matter, not only because of the analytical complexity of the problem but also because the configuration of financial systems changes, as well as differing from one country to another. The range of contracts (as regards the variety of assets, terms and denominations) and the forms of intermediation seem to depend on the past history of the economy. Although it is useful to seek criteria that can be applied more or less generally, these specific features need to be taken into account.

These special characteristics become clear when one considers the links between the credit markets and the exchange rate regime. At one extreme, there are the cases where a large part of the assets issued by residents of a country are in the hands of other residents and the instruments are mostly denominated in local currency; when the agents display a demand for liquidity they are likewise showing a propensity to increase their local currency holdings. This means, on the one hand, that if there are massive withdrawals of funds from the financial system and the public sector is called upon to act as lender of last resort, a currency issue will not always immediately lead to pressures on the foreign exchange market if the increase in the money supply is matched by greater demand. Likewise, movements in the external parity of the currency need not necessarily have a substantial effect on the willingness to offer credit, because asset-holders consider above all the purchasing power of their positions in terms of domestic goods: as long as domestic inflation does not change too much, fluctuations in the exchange

rate do not have much effect on individuals' perceptions of their wealth or expectations regarding debt service capacity, although they do change relative prices and the incentives for different types of activity.

At the other extreme, there is the case of a highly dollarized economy, where the liquidity reserves consist mainly of foreign exchange and financial contracts are mostly denominated in foreign currency. Here, in particular, a fall in the willingness to keep funds in the banks when there are doubts about the soundness of those entities is quickly reflected in greater demand for external assets and the government is thus induced to provide those assets in one form or another if it wishes to avoid a situation where the financial system ceases to fulfill its foreign currency commitments (when the effects of the shock on the exchange rate are so serious that the withdrawals of foreign currency deposits cannot be made good with the corresponding liquid assets of the intermediaries), preventing the shift of the local currency deposit portfolio to liquid foreign exchange. In an economy of this type, an exchange rate devaluation automatically leads to a revaluation of liabilities and operates as a debt deflation mechanism of the type described by Fisher (1933): it thus has wealth effects and can in itself bring on a contraction in credit, by bringing into question the solvency of borrowers (and probably also by rendering more uncertain the real value of payments for contracts using the denominator previously applied by convention). Thus, in these circumstances it is very likely that a devaluation will help to spark off or heighten a recession. The dollarization of credit acts as a strong disincentive against allowing major movements in the exchange rate.

There is of course a wide range of intermediate cases between the two extremes in question.¹³ How-

ever, it may be noted that attitudes to variations in the exchange rate differ according to the economy in question: in some cases governments go to great lengths to limit the size of exchange rate swings, whereas in others they give priority to other criteria. At this point, it is worth considering why exchange rate flexibility can be useful. Limited fluctuation of the exchange rate can introduce a certain amount of friction into capital movements and give monetary policy some degree of autonomy; at the same time, the price of foreign exchange acts as an adjustment mechanism for relatively small disturbances. The main question, however, is what the response to very strong disturbances should be: i.e., if it is acceptable to allow the exchange rate to register a correspondingly large variation. When this is not so (either because of the characteristics of the financial system or because it is considered that exchange rate stability and price stability are closely associated),¹⁴ it seems reasonable that the exchange rate regime should try to reduce uncertainty about the possibility of a major devaluation; keeping the option open would then mean paying a certain price (especially in terms of high interest rates, with the corresponding problems for public and private debtors) in order to maintain a degree of flexibility that there would be little inclination to use when the time came. On the other hand, if the reaction of the market to exchange rate uncertainty is to make wider use of foreign currency in contracts, then this—as already noted—tends to make it more difficult to use the exchange rate as a means of adjustment. It is also clear, however, that rigidity entails its own costs, which become particularly evident when there are disturbances of external origin. The dilemmas that arise in choosing exchange rate systems emphasize the fact that there is no simple regime which is definitely preferable to the other alternatives, whatever the characteristics of the economy.

¹³ This variety concerns not only the relative proportions of financial contracts denominated in local or foreign currency but also the use of schemes such as price indexing, which is often applied in some countries (and is usually associated with a history of inflation which is persistent but does not reach extreme levels). From the point of view of our analysis, indexed contracts are quite a different matter from those denominated in foreign currency, since the real value of the payments does not depend directly on variations in the exchange rate. Indeed, a sudden rise in the exchange rate would tend to reduce the real value of indexed debts (in so far as it is associated with a rise in domestic inflation, and bearing in mind that the price indexes currently applied have lags), whereas it would increase the real value of commitments expressed in foreign currency (if domestic prices vary less than proportionately).

¹⁴ The analysis made here has laid stress on the disturbances in the system of financial contracts that can be caused by big variations in the exchange rate in economies where many debts are expressed in foreign currency. Past experience (including that of recent episodes) suggests that abrupt devaluations are generally associated with considerable rises in the real exchange rate: this means that there is not an equally sharp response by domestic prices. Even so, in some cases the exchange rate is the main nominal anchor; this feature can also be linked with the ways contracts are denominated.

The dollarization of financial assets can of course be induced by economic policy measures, but it can also occur more or less spontaneously. Within the limits of the influence of economic policy, there may be options which are by no means unimportant: the spread of the use of foreign currency as a unit of account in financial operations restricts monetary management in a manner which it may be difficult to reverse, but in some conditions it seems to be almost essential in order to endow the credit markets with a certain density, especially in the case of transactions which are not of a very short-term nature. These conditions may also be associated with attitudes on the part of the public which require that capital movements with the exterior should be smooth and easy if assets are to be kept in the country.

It is quite natural that the variability of international flows of funds should have given rise to discussions about the treatment that should be given to different forms of movement of resources (Agosin and Ffrench-Davis, 1997; UNCTAD, 1998). It is worth bearing in mind, in this respect, that (except in conditions of strict rationing) the volume of external finance is not an externally given quantity but is determined in conjunction with the decisions on production and expenditure, and therefore depends on the expectations and behaviour of the agents in the economy itself. Nevertheless, great fluctuations have been observed in the supply of credit from the central countries to the rest of the world, and these oscillations have had similar effects in very different economies. Changes in the opportunities for access to international credit have undoubtedly become macroeconomic impulses of prime importance – just as important as variations in the terms of international trade, if not more so¹⁵ and in a variety of cases they have given rise to abrupt changes in the rates of real expenditure and production. Such instability causes problems. What is less clear is how far it is possible to reduce the transmission of externally made valuations to the yields on domestic assets: in economies which are already integrated into the international capital market it would seem difficult to generate frictions that could avoid cases of arbitrage outside very limited ranges and thus prevent major

¹⁵ On the other hand, these two types of impacts can well be linked: the effects of a fall in export prices can be amplified by a contraction in the supply of finance.

shifts in international interest rates or the risk perceptions of external operators from being reflected in local markets.

Capital movements take the form of changes of ownership of different types of assets. A widespread source of concern is the possibility that there may be rapid reversals of short-term capital flows which force a sudden contraction in expenditure if creditors demand that their loans be paid off. The concentration of finance in short-term instruments is undoubtedly an element of fragility, since there are generally no matching resources rapidly available for servicing debts. Apart from the normal activity of changing maturities carried out by the financial system, it is only reasonable that public or private agents should try to avoid major discrepancies between the time-patterns of their income and obligations. Here too, however, dilemmas can arise. At times of uncertainty, suppliers of credit will probably show a preference for flexibility, and this will lead to big differences in yields, depending on the length of the loan. In these circumstances, a rise in long-term interest rates is in itself an impulse favouring a contraction in aggregate demand. At the same time, the fact that debtors prefer to obtain longer-term loans does not give any indication of what spread they would be willing to pay.¹⁶ At the limit, if the cost of long-term indebtedness becomes prohibitive, the stark choice may be between accepting shorter maturities on liabilities or reducing expenditure immediately. The first of these choices means wagering that credit conditions will ease in the future if the reigning uncertainty is dispelled, which may or may not occur; at all events, the fragility produced by a concentration of short-term debt is probably the effect of some problem (reversible or not, depending on the circumstances) of perceptions of creditworthiness. In many cases, strategies based on the idea of gaining time may end up in a collapse (due to the refusal of creditors to keep on refinancing the debt), but this depends on the specific circumstances, so that it is difficult to formulate a general proposition.

¹⁶ At this point, the indeterminate nature of the probabilities of different situations becomes important if there are multiple equilibria, because if these probabilities are not known it is not possible to define accurately the value, for the recipient of a loan, of "insurance" against the possibility that his creditors will decide not to refinance the loan and will demand the return of their funds.

Similar dilemmas may appear in other areas, especially in the interaction between financial and exchange rate policies. It is not unusual for episodes in which there is a break with a fixed exchange rate regime to be associated with bank crises (Kaminsky and Reinhart, 1996). There is clearly a relation between the two phenomena: when banks begin to have liquidity problems, there will probably be a conflict between the need to act as a lender of last resort and the maintenance of enough international reserves to back up the exchange rate. It is hard to imagine the central bank (or the public sector as a whole) remaining on the sidelines if there is uncertainty about the repayment of deposits in the banking system.¹⁷ But an expansion in the money supply to help the banks involves the risk of increasing the demand for foreign exchange, and raising interest rates in order to maintain the level of the reserves may aggravate the situation of debtors. Here too, policy management in the face of these dilemmas (which also involve fiscal management) seems to call both for a judgement on the nature of the shock and for various types of conjectures: how far has loss of confidence spread through the system as a whole?, is there an irreversible deterioration in portfolio quality, and is this limited to only a few firms or not?, how much access do the banks have to foreign funds?, what prospects does the government have of obtaining external resources?, how will the demand for money respond to an increase in official credit to the banks? and so forth. In order to size up the situation in these conditions it is necessary to collect and process information, but above all to formulate a general view on the basis of the available indicators, although the time available for deciding on actions is very limited (and the planning horizon of the private agents is shortened too): by their very nature, crises raise very complex decision-making problems.

A first element for reducing the probability of acute crises is to recognize that, although their frequency and intensity cannot be determined precisely,

major disturbances in the assets markets do occur from time to time, and economies are particularly likely to suffer them if they are very sensitive to international conditions or are undergoing changes in their configuration which can give rise to potentially volatile expectations. This recognition will naturally lead to more or less continuous activity in the detection of signs of problems.¹⁸ This point applies in particular to the banking system. There is no need to stress the importance of supervision and of the application of prudential regulations on capital inflows, liquidity and the way to treat credit risks, which reduce the system's exposure to aggregate impulses and forestall faulty management of the institutions in question and the generation of serious moral hazard problems (Rojas-Suárez and Weisbrod, 1996; De Juan, 1996). Experience shows that shortcomings of supervision appreciably increase the fragility of the banking system (and, ultimately, can give rise to heavy contingent debts for the government) and, conversely, that the strengthening of prudential control mechanisms puts the economy in a better position to absorb shocks.

Likewise, if the government incorporates in its decisions the possibility that it may, in certain emergency situations, be obliged to provide liquidity assistance to the financial sector or to face situations of volatile demand for money, as well as recognizing that exchange rate instability can entail high costs, it will be advisable for it to maintain a relatively high volume of readily available reserves (as a proportion, for example, of bank liabilities not covered by their own liquid foreign exchange holdings). Obviously, in order to build up these funds in conditions of price stability it will be necessary to generate present or future fiscal surpluses (or at least not use the resources from seigniorage for expenditure if the demand for money increases) and to freeze assets that could be used for other purposes. At the same time, the availability of resources for use in emergencies

¹⁷ And an announcement by the authorities that they will refrain from taking action may have only a very limited effect on exchange rate credibility, because the collapse of the banks will very likely have repercussions on the public finances, either directly, if the government finally covers the losses incurred once the problem has worsened, or indirectly, through a fall in aggregate activity: it is an example of "unpleasant arithmetic" (Sargent and Wallace, 1981), involving a temporarily contractive monetary policy to deal with a probable deterioration of the fiscal position.

¹⁸ Apart from the importance of looking for signs that will give early warning of disturbances, it will probably be difficult to identify reliable advance indicators in general terms, precisely because the problem is to predict sharp reversals of expectations, and this does not appear to permit the use of purely mechanical procedures.

provides a means of giving greater credibility to the financial and exchange system and provides some flexibility of action for softening the impact of fluctuations in the asset markets: accumulating funds does involve costs, but on the other hand the existence of such funds allows policy measures to moderate interest rate rises when there is a contraction of credit and at the same time reduces the risk that the exchange rate may be destabilized.

Nevertheless, it seems unlikely that it would be possible to define regulations which, without imposing excessively strict limits on intermediation operations (and hence without excessively restricting credit to those units which rely on the banks for their finance, typically small enterprises), at the same time reduce the likelihood of systemic problems in the banks to the minimum. This means that there will not be "full-coverage insurance". Furthermore, experience shows that volatility of securities values can also give rise to considerable fluctuations in credit conditions. Likewise, regardless of whether the public sector has built up reserves as a preventive measure or not, it is possible that the economy may be faced with such serious conditions of illiquidity that its capacity for policy intervention on the basis of the assets at its direct disposal is exceeded. The episodes of recent years have shown that, one way or another, international emergency finance has played an appreciable role in efforts to moderate the effects of shocks on various economies. Both for this reason and because of the interdependencies which exist between different economies, we will now analyse the question of possible international arrangements to deal with episodes of very strong turbulence.

3. The international transmission of impulses

There are various types of channels for the international transmission of macroeconomic impulses. In addition to the traditional mechanisms (through trade operations and market conditions in the financial centres), in recent times special attention has been paid to the effects of common movements in the asset prices of different countries. These effects can themselves be due to different causes, such as:

- i) changes in the international economy which are reflected in a similar manner in several countries;
- ii) direct impacts of some economies on others (through trade, for example), which are incorporated into the perceptions on asset yields;

- iii) perceived analogies in the configurations or policies of countries, which cause certain agents to interpret some events in one economy as being useful for predicting the behaviour of others; this mechanism would appear to operate in a context of learning about the fundamental variables, through information perceived as being capable of being extended to other cases which individuals extract (rightly or wrongly, in retrospective) from the evolution of different economies;

- iv) spillover effects, because the liquidity constraints of operators specializing in holding securities of a group of countries would cause them, in the event of falls in the prices of some securities, to sell off other assets¹⁹ (Calvo, 1998); this would have effects that could be amplified by cases of "herd behaviour" on the part of other agents who base their decisions on the observed actions of the first group,²⁰ either because they think they reflect useful information (Banerjee, 1992) or because they are applying "follow the market" strategies due to principal-agent problems²¹ (Krugman, 1998);

- v) possible "self-fulfilling prophecy" phenomena sparked off by certain events which act as focal points for the coordination of expectations.

¹⁹ It should be noted that this argument calls for some particular hypotheses in order to rationalize strong contagion effects: one of these hypotheses is that such specialists (who would have more information than that possessed by the average operators in the market about conditions in the respective economies) have a portfolio that contains debt of different countries at the same time. A proposition resulting from this argument (although there is no clear evidence that this has been observed in practice in recent episodes) is that specialists who have few holdings of securities of the country which set off the downward movement in prices, or who do not suffer from liquidity constraints, should simultaneously increase their demand for debt of the other countries and thus moderate the severity of the contagion.

²⁰ It is worth recalling that information cascades—in which agents imitate the actions of the others instead of relying on direct first-hand information—are more likely when the information the agents possess themselves is considered unreliable. The appearance of such effects would thus seem to indicate a pre-existing state of uncertainty.

²¹ This refers to the fact that portfolio managers may be evaluated by their clients by comparison with the evolution of the market average, thus making them reluctant to take positions that are much different from "general opinion".

There are some indications that in critical episodes there is increased correlation between the demand for assets of different countries.²² However, it is hard to distinguish the effects of the different mechanisms that could have operated in each case, and still harder to determine the importance of such mechanisms in possible future cases. Furthermore, although certain indicators of fragility may be useful, it is not clear what specific conditions make an economy more vulnerable to contagion. Thus, from a prospective point of view, the question is posed in very general terms: there are sometimes states of great uncertainty in which the effects of the international transmission of financial disturbances are heightened and are added to the spread of impulses through trade.

It is well known that the existence of international spillovers can give rise to demands for the coordination of macroeconomic policies. At the same time, crisis situations usually compromise as a whole the macroeconomic instruments of countries and therefore typically reduce the degree of freedom for determining the "coordination supply" (Heymann and Navajas, 1992). Recent experience is instructive in this respect: in the countries directly affected by disturbances there was no sign of significant activity for the joint determination of macroeconomic measures. Instead, there were "emergency" mechanisms for the provision of liquidity, defined by the central countries and international loan agencies with the aim of reducing the impacts on the various countries and inhibiting the spread of the upsets to other countries. At all events, the criteria and procedures behind these interventions continue to be the subject of heated debate.

When analysing possible international-scale macroeconomic action it is necessary to bear in mind the great variety of actors involved: the residents of the individual countries, in their roles as economic agents and participants in domestic politics; the operators on the international financial markets; the authorities who define policies in each country; regional coalitions, whether of a lasting or temporary nature, and the relevant international institutions. In circumstances like these, in which multiple agents with different interests, relative weights and possibly different perceptions interact with each other, the

"game" that gives rise to decisions is by no means simple. Nevertheless, there are some basic features which are obvious even at a cursory glance.

A first point which is obvious but nevertheless worthy of note is that the behaviour of the central economies has strong external repercussions: the evolution of the economic cycle, of exchange parities and of credit conditions in those economies acutely influences the opportunities of other regions. The policies of the central economies are naturally decided as a function of domestic considerations; there is little coordination among them, and the impacts on third countries, if taken into account at all, are only considered in critical situations, when widespread, large-scale upsets are observed that could affect them. Obviously, differences of size give rise to differences in behaviour, and these are a fundamental given element of the problem. However, it seems important to acknowledge the international effects of policies and to establish arrangements whereby at least the countries or regions that receive the impact of impulses can participate by transmitting and receiving information on the future prospects of the economies and policy lines. Arrangements for interaction are by no means an insignificant element in decision-making, even though they may not take the form of explicit commitments. They are also important in so far as it is sought to prevent international-scale disturbances and to establish guidelines on action to deal with them if they do occur, because although big macroeconomic swings occur in an occasional manner it would be desirable to follow up the evolution of the international economy more or less continuously, with the participation of policy-makers (ECLAC, 1998b; Ocampo, 1999).

The set of emergency financing measures applied in recent episodes implicitly recognize the fact that, in certain circumstances, the possibility of handling crises goes beyond the national level. These episodes have given rise to a debate on the desirability of establishing some more formal mechanism for acting as an international lender of last resort. Defining systems of this type is undoubtedly a difficult matter. There are, of course, moral hazard problems, both for the lenders and the recipients of the funds. However, the cost of the crises for the debtor countries has generally been high (even when they have received emergency credits to bolster up their liquidity), so that it is hard to see what incentives there could be for them to engage in policies which volun-

²² See, for example, Calvo and Reinhart (1996) and Eichengreen, Rose and Wyplosz (1996).

tarily increase the likelihood of an adverse shock. Moreover, since it is generally considered very important to maintain easy access to international markets, possible opportunistic forms of behaviour would probably be limited by considerations of reputation. At the same time, the discretionality inherent in the function of lender of last resort could become a source of conflicts if this function were carried out by an international agency; something similar would apply in the case of the functions of supervision of financial systems associated with that role.

These arguments (quite apart from the uncertainty about the size of the funds that might be needed in different circumstances and the difficulties involved in making advance commitments to contribute resources, if the latter were very large) would suggest that credit aid to economies facing crises should be maintained as a possibility to be decided when the case arises. Such occasional schemes also present problems, however, especially as regards the timeliness of the measures (which would tend to be taken only when the crisis was clearly acute), the criteria on the availability and use of the resources, and the definition of the conditions applicable to such aid. Here, once again, there are dilemmas and trade-offs. It would seem possible to devise mechanisms defining the basic criteria (such as those on fiscal performance and the supervision arrangements applied by countries to their financial systems) regarding the requirements that an economy must fulfill in order to have access to contingency finance in the event of disturbances in credit facilities (see for example Agosin, 1999). Such criteria would necessarily be rather arbitrary when the time came to apply them, and their announcement could amplify the fluctuations in some cases, but they would nevertheless provide an element of predictability and would possibly facilitate the operation of counter-cyclical policies, especially to deal with signs of contraction.²³

²³ What would be desirable (although undoubtedly hard to do in practice) would be to help to identify impacts of a transitory nature and cases where the upsets are not due to previous departures from "good" policies, so that prudence in times of expansion would be rewarded by greater capacity to keep up the level of activity in crises. In this respect, credit risk ratings have given rise to heated debate because of their possible pro-cyclical effect (ECLAC, 1998b).

The regulation of credit markets has an international aspect: the financial fragility of some economies has repercussions on others, and the rules laid down by the central countries undoubtedly affect the conditions of access to resources for the rest of the world. This justifies the attempts to define international standards (not necessarily identical for countries with different characteristics, or fixed over time). At the same time, although it is natural that there should be concern over the volatility of the supply of credit for the emerging countries and its effects in terms of amplifying and spreading fluctuations, there might be a danger that, if there were strict regulations in the central countries, these could operate as a sort of tax on the export of resources which might affect the amount and cost of credit for countries requiring finance.

In some groups of countries, a substantial part of their trade in goods is with neighbouring countries in their region but financial transactions are mainly with the centres. This is so in the case of Mercosur (although the geographical concentration of trade varies between the countries). In such conditions, it seems useful to analyse possible policy coordination exercises, not in a "self-contained" context (where only the regional participants are actors) but bearing in mind the effect that the behaviour of each economy has on the interaction (especially in financial matters) of the others with the rest of the world. In order for a number of countries to agree to engage in the coordinated management of their macroeconomic instruments, the perceived incentives must be very strong. There must therefore not only be close economic interdependence but also previous experience in forms of coordination which do not restrict the decisions of the parties too much: at all events, concerted policy definition is always a gradual process. The macroeconomic spillover is also more intense if there is a regional component in the supply of finance to each economy, however. Quite apart from the usefulness of mechanisms for consultation and the exchange of information, it may also be beneficial to define some regional guidelines of a macroeconomic nature (whether or not in the form of explicit commitments) aimed at reducing uncertainty about the mutual impacts between the economies.

IV

Final comments

Decisions on saving, investment and asset holdings depend on expectations which vary with changes in perceptions and forms of analysis. These changes sometimes cause major shifts in the perceived opportunities of the agents, especially when doubts set in about the creditworthiness of debtors. It is difficult to define the likelihood of major disturbances accurately; the mechanisms behind the spread of impulses in these cases also seem complex. It would be dangerous, however, to ignore the potential volatility of the supply and demand of credit, especially when one bears in mind that economies are constantly evolving, so that the patterns of behaviour observed in the past are of only limited validity for judging how agents make their forecasts.

A basic responsibility of economic policy is not to become a factor of instability itself; at the same time, it should act to forestall and moderate serious macroeconomic fluctuations. In order to do this, the public sector must keep itself financially sound and use its leeway for action to cope with critical situations. Even so, it is likely that in certain circumstances the magnitude of impacts and their transmission from one economy to another will make it essential to take measures that go beyond the national level. Linking up policies to forestall and deal with crises at the national, regional and international level raises by no means negligible problems of design and implementation.

(Original: Spanish)

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Automatic *fiscal stabilizers*

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In this article, indicators of fiscal discretionality are estimated using a simple methodology, and in this way the cyclical component of the public accounts balance (i.e., the amounts of income and expenditure associated with transitory movements of the level of activity) is identified for a number of Latin American countries in the 1990s. The difference gives a measure of the discretionary balance, which represents a medium-term indicator of the state of the public accounts. Budgetary rules which take account of these mechanisms not only ensure sustainability over time but also reduce the cyclical nature of the public finances, provided they are applied in a transparent and symmetrical manner. This method provides series which make it possible to follow up the structural and cyclical components of public deficits in Latin America, using a standard methodology and with minimal information needs, in order to focus the relevant discussions (and the necessary adjustments) on a medium-term horizon.

I

Introduction

The challenge of reconciling macroeconomic stability with satisfactory growth and improvements in income distribution can only be faced by shaping a new "fiscal covenant" in the region (ECLAC, 1998). This fiscal covenant must be based on solid foundations, with an institutional design which takes due account of the two sacred principles of stability and responsibility. The principle of stability means that the government must manage the public finances in a transparent and predictable manner, in keeping with the objectives of high and stable rates of growth and employment. The principle of responsibility, for its part, means ensuring the long-term sustainability of decisions, while avoiding disproportionate tax burdens or excessive levels of public debt. Fiscal policy has two macroeconomic objectives: sustainability of the fiscal accounts and regulation of aggregate demand; clearly, efforts have been concentrated on the first of these, leaving the stabilization role –when it has existed at all– to monetary policy. In order to construct this new fiscal covenant, governments must recover greater degrees of freedom and take on a more active role in the task of reducing the volatility of the economies and improving their macroeconomic performance.

In this article, emphasis is placed on the importance of creating suitable conditions for the full operation of the automatic fiscal stabilizers in the design and application of fiscal policy (section II below). As in previous studies (Martner, 1996 and 1998), the aim is to prepare some simple indicators that will make it possible to assess the importance of the cyclical component in the public sector accounts in Latin America. Fluctuations in the level of economic activity have a significant influence on the public accounts and also have a stabilizing effect on GDP. The automatic fiscal stabilizers may thus be defined as those types of public income and expenditure which are directly linked with the economic cycle. For a given budget, when there is lower economic growth

there will be a public deficit whose counterpart is lower tax payments by the private agents. This apparent fall in taxes avoids a reduction in those agents' income and excessive contraction of their expenditure, thus moderating fluctuations in their demand.

The automatic fiscal stabilizers help to stimulate the economy in periods of recession and moderate it in booms, thus exercising a regulatory function. Governments have the option of allowing these automatic stabilizers to operate without intervention, or strengthening or restricting their effects through discretionary policies. During a recession, for example, the instinctive reflex reaction of the authorities is to avoid an increase in the public deficit by applying pro-cyclical policies that tend to make the situation worse. It is therefore vital to weigh the mechanisms applied carefully in order to avoid over-adjustments that can seriously harm the general economic situation and the efficacy and efficiency of public policies.

If the aim is to seek a balanced budget in "normal" economic conditions, it is necessary to assess the influence and persistence of these automatic fiscal stabilizers in Latin America. The importance of these mechanisms depends on many factors, including the weight of the public sector in the economy, the progressiveness of the tax system, the existence of public employment and unemployment benefit schemes, and the sensitivity of unemployment to variations in the gross domestic product (GDP). These structural characteristics vary considerably from one country to another, and also over time.

What must be done above all, however, is to define what "normality" means, and with it the position of the economy in the cycle. Economic policy management is inconceivable without a due distinction between trends and cycles (section III). The old concept of the product gap is defined as the distance between the effective GDP and the trend GDP, and it seeks to provide a simple summary measure of such normality. Many methods have been proposed –both statistical and structural– for identifying the position of the economy with respect to its growth potential. In order to make a proper diagnosis it is of crucial importance to distinguish between three concepts

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that tend to be confused with each other: the potential GDP, the trend GDP and the mean GDP. The potential GDP is defined as the level of activity compatible with a stable level of inflation. The trend GDP may be distinguished from the mean GDP because it incorporates stochastic components, which means that the most recent years are assigned greater weight than those further back in the past. If trend growth and mean growth are confused with each other, this gives a linear representation of the GDP gap which may not properly describe the situation of economies subject to continual supply disturbances. The statistical methods used to estimate the potential GDP assume that it oscillates around the effective GDP, so that a sustainable growth rate cannot depart very much from the recent past, as recorded in the trend GDP. Subject to these clarifications, we can speak indifferently of the trend and potential GDPs, in so far as the former is the direct consequence of the latter. If what is sought is an elementary and immediate measurement of the GDP gap, the Hodrick-Prescott (HP) filter provides an estimate of the trend GDP, which is assimilated to the potential GDP through the assumption of symmetry of the macroeconomic cycle.

In this article, a detailed analysis is made of the estimation of the GDP gap for twelve countries of the region in the 1990s (section III). In order to facilitate comparative analysis, we have used the method of estimation employed by the European Commission, which (leaving aside the question of the virtues or shortcomings of this method) defines the GDP gap as the difference between the effective GDP and the potential GDP, expressed as a percentage of the latter.

In Latin America, the relative size of the cyclical public deficit depends on the magnitude of macro-

economic fluctuations and the sensitivity of public income to the level of activity. Using a number of simplifying assumptions, in this article we calculate the magnitude of the automatic fiscal stabilizers and present estimates of the cyclical balance of the non-financial public sector for twelve Latin American countries in the 1990s (section IV). According to these calculations, the cyclical component reaches maximum levels exceeding one percentage point of GDP in the countries with the highest tax rates and/or the greatest volatility, such as Argentina, Brazil, Chile, Peru and Uruguay. Although these figures are lower than those for the countries of the Organization for Economic Cooperation and Development (OECD), they are nevertheless quite significant, in view of the limited leeway for fiscal policy management in our region. Applying anti-cyclical policies is usually a complex matter in practice, but failing to do so may be even more harmful. What is involved is the creation, through explicit mechanisms, of the spaces necessary for the full operation of the automatic fiscal stabilizers. When short-term fiscal balance goals are fixed, both the national authorities and international agencies should take the effects of the prevailing situation into account.

Budgetary rules which provide for these mechanisms can not only ensure sustainability over time but also reduce the cyclical nature of the public finances, provided they are applied in a transparent and symmetrical manner. It is therefore necessary that there should be ongoing monitoring of the structural and cyclical components of public deficits, using standardized methods and up-to-date information, in order to focus discussion (and the required adjustments) on a medium-term horizon (ECLAC, 1998).

II

Creating spaces for the operation of the automatic fiscal stabilizers

As we have seen in the case of a number of countries of the region in recent decades, the budget may be involved in a situation of explosive ("snowballing") growth of the public debt, in which a growing proportion of income is generally absorbed by interest

payments. Unless irresponsibly expansionary policies are being applied, this perverse dynamic is usually exogenous to the public sector. The stability of the debt/GDP coefficient depends of course on the difference between the growth rate of the economy

and the real interest rate at which the public sector is contracting debt. When the former rate is higher than the latter (positive differential) it is possible to finance a certain level of deficit by indebtedness without increasing the public debt burden, but when the differential is negative, the persistence of a primary deficit gives rise to explosive growth of the debt and of interest payments which endangers the solvency of the public sector. In this way, if the interest rate rises and the growth rate falls, the sustainability of fiscal policy is immediately brought into question.

Thus, a restrictive monetary policy has an adverse impact on the public sector, especially if the exchange rate rises and the public debt has a significant external component. The efficiency of exclusive and/or excessive use of monetary policy to stabilize the economy is open to doubt. Management of the interest rate helps to correct unsustainable movements in private expenditure, but it can also generate or aggravate a dynamic which is potentially destabilizing on the fiscal side. Lack of coordination between monetary and fiscal policies leads to a situation marked by excessively high interest rates and a high public deficit.

So, if the objective is to stabilize the public debt but monetary financing is not available, a situation of stagnation and high interest rates makes it necessary to generate increasingly large primary surpluses. When a public balance target is fixed independently of the evolution of the level of activity and the rest of the macroeconomic variables, budgetary policy becomes markedly pro-cyclical, reducing expenditure or increasing taxes every time the interest rate rises or the level of activity goes down. This type of budgetary management heightens the uncertainty of the environment in which private decisions are taken. By rationally anticipating this policy, the private agents will tend to act in a pro-cyclical manner, since a slackening of public demand will foreshadow a reduction in private demand. Thus, adopting deficit and public debt targets without considering their effects on macroeconomic stability pushes the economy towards a recessionary trap in which the deficit targets cannot be fulfilled because of the private sector adjustment and the fiscal adjustment further depresses private activity. The stabilizing potential of fiscal policy has not been sufficiently used in our region, which is marked by excessive fluctuations that adversely affect long-term growth.¹

¹ For an analysis of the correlation between real volatility and growth, see Martner (forthcoming).

1. Reducing the severity of economic cycles

The sustainability of fiscal policy is usually defined as a state of stability of the public debt in a deterministic world, but it can also be interpreted as a stationary state of that debt in a stochastic world (Hénin, 1997). The government is solvent if the public debt/GDP or public balance/GDP ratios are stationary variables. Sustainability is simply the long-term solvency of the government, which means that it must respect its inter-temporal budgetary constraints. What endangers the government's solvency is not so much a deficit as the persistence of deficits at an excessive level.

The neoclassical theory of tax smoothing holds that tax rates should be kept constant over the economic cycle in order to minimize the costs arising from distortive taxes. Optimal fiscal policy gives priority to sustainability over time, thus leaving room to adapt the public balance to the macroeconomic circumstances. The normative component is flexible, with a constant rate of taxation being preferred to an annual budget balance rule. Bohn (1995) considers that fixing ceilings for the deficit and the debt with a probability of 1 is an over-restrictive rule in a stochastic world.

The Keynesian view of this stochastic world is not very different from the foregoing. For traditional Keynesians, fiscal policy should ensure surpluses in situations of full employment and accept deficits in recessions, giving a zero average balance over the cycle. Although some authors do not emphasize it as much as it deserves, the principle of fiscal responsibility is an integral part of the traditional Keynesian message. As noted by Tobin (1993), the Keynesian macroeconomic concept applies to both sides of the medal: a fiscal surplus is the right means for containing excess expenditure, while a deficit is an element which can help to overcome situations of recession. Macroeconomic stabilization calls for counter-cyclical regulation of demand, applied in a reasonably symmetrical manner. The difference from the neoclassical view is that in this case it is legitimate to adopt more active regulatory policies, leading to more pronounced fluctuations in the fiscal balance, but always giving a result of zero over the cycle as a whole.

The degree of smoothing of the economic cycle achieved through the automatic fiscal stabilizers differs significantly from one country to another, depending on the structure of taxes and expenditure

and the degree of openness of the economy. Fiscal policy is naturally less efficacious in more open economies: much larger budgetary fluctuations are needed in order to obtain the same degree of stabilization of GDP. The OECD (1993) considers that, in the case of the European economies, the operation of the automatic stabilizers reduces the magnitude of cycles by 25%; Pisani-Ferry, Italianer and Lescure (1993) estimate a stabilizing effect of over 35% in Germany and France. In the case of more closed economies, such as the United States and Japan, the effect is even more significant, even though the fiscal stabilizers are smaller (OECD, 1993). In the case of the United States, Weise (1996) calculates that elimination of the anti-cyclical reaction of the public balance (offsetting the deficit with smaller expenditure) would increase the magnitude of recessions by between one-third and one-half. Finally, the European Commission (1997), using simulations carried out with the QUEST model, calculates that the stabilizing impact is around 30%: in other words, fluctuations in GDP are reduced by almost a third in comparison with a situation where the changes in public expenditure and income are not offset by others which compensate for them. As we can see, the role of the automatic stabilizers in fiscal policy management is once again being actively debated in the industrialized countries.

Let us now write the equation for the public deficit as follows (European Commission, 1997):

$$d = d_e - (\alpha + \beta)GAP \quad (1)$$

where d_e represents the fixed structural component of the public balance, α is the marginal sensitivity of the public balance to the GDP gap, β is the discretionary reaction of the authorities to the cycle, and GAP is the GDP gap, as defined below. The fixed structural component should be zero, if there is no deficit skew. The tax smoothing theory also assumes that there are no discretionary policies, so that $\beta=0$. In this case, the aim of fiscal policy is to maintain a constant tax rate, so that, as a corollary, the public debt absorbs the cyclical fluctuations, allowing the spontaneous automatic stabilizer mechanisms to come into action.

Curiously enough (albeit using different arguments), both old Keynesians and supporters of the new classical economics prescribe similar rules for fiscal policy. This kind of "theoretical agreement",

which gives priority to the objectives of tax smoothing and/or regulation of the level of activity rather than annual deficit targets, seeks consistency over time through explicit agreements on the control of the public debt throughout the cycle. A policy of this type, though optimal for the efficient management of the public finances, is based however on vulnerable and/or controversial assumptions, such as the need for a certain symmetry in the cycles and the absence of lasting effects of the latter.

Such theories accept that deficits may be legitimate or even necessary in periods of crisis, but the recommendation that surpluses should be generated in periods of full employment has been less successful, since there is ample evidence of a bias towards a structural negative balance. The absence of fiscal discipline in modern democracies has been analysed on the basis of the linked concepts of fiscal illusion and asymmetrical stabilization policies (Buchanan and Wagner, 1977). Fiscal illusion means that voters do not fully grasp the implications of the government's constraints over time. When they are invited to support a programme of expenditure to be financed with a larger deficit, voters overestimate the advantages of that expenditure and underestimate the future tax burden it will involve. Opportunistic politicians take advantage of this situation to increase expenditure more than income. According to this view, Keynesianism greatly encouraged the appearance of excessive deficits and the abandonment of the responsible rule of balanced fiscal accounts. In the past, Keynesian recipes have been asymmetrical: politicians are always ready to accept deficits in periods of recession, but they forget to generate surpluses once the recession is over. An argument close to the concept of the fiscal illusion is that of the policy cycle. Voters reward demagogic politicians without understanding, or without learning from the experience of their own or other countries, that expansionist policies must be paid for some day. At election time, politicians in the government expand public expenditure, which has to be financed by voters after the elections.

Recent publications explain the persistence of deficits and debts by institutional considerations. In this respect, Von Hagen (1992) investigated the importance of budgetary institutions in the evolution of indebtedness and prepared structural indexes for twelve OECD countries as a function of five national characteristics: i) the power of the Prime Minister, or

of the Minister of Finance, in negotiations within the government; ii) the limitations on parliamentary amendments; iii) the way the budget is voted in parliament (globally, or item by item); iv) the degree of transparency of the budget, and v) the flexibility of the budget implementation process. The information put forward in support of the structural hypothesis is convincing: the indicators on the type of budgetary institutions do indeed help to explain the differences in deficits and debt/GDP ratios between the OECD countries.

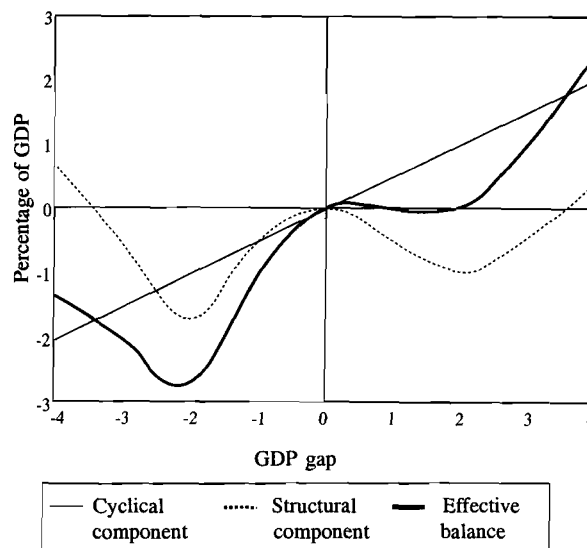
Alesina, Haussman, Hommes and Stein (1999) made a similar study for the Latin American countries, using information on legislation and effective budgeting practices obtained through questionnaires answered by the persons responsible for budgetary policy in the various countries. Indicators of budgetary procedures were constructed for twenty countries, on the basis of ten particular features of the process, ranging from restrictions and controls on public indebtedness to requirements for the adoption of amendments in Congress and including the degree of autonomy of local governments and public enterprises as regards decisions on indebtedness. The empirical results were consistent: when considering the various economic determinants of the deficit it was confirmed that procedures which are more clearly defined and/or transparent help to secure greater control over the fiscal deficit. Naturally, except in a few cases, the procedures are not responsible for the deficits, but it is also a fact that the prevailing institutional arrangements do facilitate or impede the capacity to react to imbalances arising from exogenous disturbances. The correction of excessively rigid procedures and of such common defects as lack of transparency and of cooperation among the different levels of government is essential if it is desired to recover control over budgetary processes, keep public indebtedness under control and, of course, improve the efficacy of public policies.

2. A transparent and consistent institutional design

However, discretionary fiscal policies usually display an asymmetrical approach which is reflected in an increase in the public debt/GDP ratio, even in periods of above-average growth. A study made in the European Union countries on the evolution between 1970 and 1990 of the cyclical and structural components

FIGURE 1

European Union: GDP gap and public balance



Source: European Commission, 1997.

of the public balance according to the GDP gap (European Commission, 1997) leads to some interesting conclusions (figure 1).

In this figure, the straight line represents the evolution of the cyclical component of the public balance in the European Union, as measured by the GDP gap, with the marginal sensitivity of the public balance to changes in the level of activity standing at 0.5. In other words, for the member countries as a whole, a variation of two points in the GDP gap is reflected in a deterioration of one percentage point of GDP in the public balance.

The benchmark situation is one where the discretionary component is zero: in that case the automatic stabilizers operate freely and the cyclical component will be equal to the effective balance.² As will be noted, this has not been the case in the European Union, where discretionary fiscal policies have been of a counter-cyclical nature when the GDP gap has been moderately negative (up to 2% of the potential GDP) or strongly positive (over 2% of the potential GDP). When there have been moderate contractions, in addition to the action of the automatic stabilizers

² Figure 1 represents a stylized situation in which it was assumed that the discretionary deficit was zero in "normal" conditions during the period studied, although in reality it was close to three points of GDP.

there has been a tendency to adopt expansionary fiscal policies, but when the GDP gap has been strongly negative governments have adopted pro-cyclical policies giving priority to short-term objectives of creditworthiness rather than regulation. In acute recessions, conflicts are heightened and it is very likely that the tendency to reduce the deficit will adversely affect the functioning of the economy. In these situations it is important to determine which is the lesser evil.

When the GDP gap is moderately positive, "mirages" tend to arise and fiscal policy tends to be relaxed, neglecting the opportunity to take action to deal with the structural component of the deficit. This is probably the commonest situation in which symmetry of fiscal policy could be secured. More determined action is called for when the economy is far above its trend level of growth, since this limits the effectiveness of economic policies and generates a bias towards a deficit and heavy public indebtedness.

As the consistency of fiscal policy over time is not something that takes place spontaneously, mechanisms must be established to secure this. The initial conditions of the public finances largely determine the reaction to episodes of recession. In the European Union, countries with moderate deficits and debts have managed to use the available room for action by applying stabilization policies. Contrary to what might be expected, the main stabilization instrument has been public expenditure in recessions, since the discretionary component of taxes has even increased (Buti, Franco and Ongena, 1997).

Preserving the intervention capacity needed to tackle adverse economic events calls for strict discipline in normal circumstances. Fiscal discipline and flexibility are thus two fundamental principles of budgetary policy in the present process of economic and financial globalization. Fiscal discipline is essential in order to give credibility to monetary policy, while flexibility is essential in order to cope with unexpected situations in a highly changeable macroeconomic environment. The first of these principles was expressed in the Maastricht Treaty, in the transitional phase to the European Monetary Union, while the second was a complement to the creation of the Euro in the Stability and Growth Pact signed in Amsterdam in the summer of 1997.

The aim of securing fiscal discipline meant that it was first of all necessary to establish eligibility criteria for the formation of the single currency zone,

imposing maximum limits for the deficit and public debt in terms of GDP, and then lay down penalties for countries that do not comply with them. The Maastricht Treaty established a ceiling of 3% for the public deficit, while the Stability and Growth Pact provided for a scale of penalties in the event of persistent excessive deficits. Continuing with the efforts to secure "fiscal virtue", the Dublin Declaration of the European Council (Dublin, May 1998) recommends members to consolidate the situation in order to arrive in the medium term at a financial position close to balance or surplus. The fiscal situation sought by the European Union countries in "normal" economic conditions corresponds to a balanced budget corrected to take account of the influence of cyclical fluctuations in economic activity.

Although this latter condition is a stricter criterion than that of the Maastricht Treaty, it provides quite a broad degree of flexibility in fiscal policy management compared with models based on permanent balance. Since the historical average rate of public investment in Europe has been 3% of GDP, a reference value of 3% of GDP for the deficit is something like a "golden rule" in public finances: indebtedness is authorized if it stays within the limits of capital expenditure (Corsetti and Roubini, 1996). If investment is profitable for the public sector, it will assure future current income flows to cover the cost of the debt. The Maastricht Treaty may thus be interpreted as an implicit rule on current account balance in the public accounts. This golden rule, which is more flexible than those calling for a balanced budget and sustainable deficits, is based on a macroeconomic rationale: the budget must be neutral with regard to the consumption and saving decisions of private agents.

In England, the rules adopted for the budget since 1998 are as follows: i) throughout the cycle, the government will only contract debt for investment and not for financing current expenditure; ii) as a proportion of GDP, the public debt will be kept at a stable and prudent level throughout the cycle (see United Kingdom, 1998). The government undertakes to act within well-defined limits, but not in absolutely strict terms. A certain degree of discretionality is maintained, as the characteristics of the cycle are not precisely defined.

In contrast, the Stability and Growth Pact, which was signed by the countries making up the Euro zone, defines an optimal medium-term path to fol-

low, and in this sense it is stricter than the "golden rule" and the Maastricht Treaty itself, since they only define ceilings for the deficit. The Pact does however allow for more flexible interpretation of the requirements in terms of the balance, since it accepts higher (though limited) deficits due to transitory cyclical factors. The procedures for the acceptance of such deficits are clearly laid down in the "Protocol on Excessive Deficit Procedure", which establishes the criteria on exceptions (excessive deficits must be due to situations outside the normal range of circumstances) and their transitory nature (the deficit can be kept outside the 3% limit only for a specified length of time). The exception clause can be invoked when the excessive deficit is due to some unusual situation which is beyond the control of the member State and has a significant impact on the financial position of the public sector. In the event of a recession which is more severe than expected, governments can exceed the 3% limit for a reasonable length of time, explaining the reasons for this. The Pact gives countries with an excessive deficit some leeway for adjusting their public accounts: they are not subject to sanctions when they suffer a recession of over 2% per year, and they can claim exceptional circumstances when the recession is between 0.75% and 2% (European Commission, 1997). As regards the clause on the transitory nature of the deficits, countries can maintain excessive deficits only during the year of the recession. If the Commission's forecasting service indicates that the country is going to continue with an excessive deficit in the year following the period of recession, it is presumed that sanctions may be in order. Thus, correction of the excessive deficit must be completed within two years after its occurrence or one year after its identification, save when there are exceptional circumstances.

As Buti, Franco and Ongena (1998) point out, the ceiling of 3% of GDP for the effective deficit is not much different from a target for the structural deficit. The only difference is that the latter can be selected by the countries themselves, fixing the optimum "buffer" in line with their own preferences. In order to identify a safe medium-term target, the magnitude of the cyclical component of the deficit must be estimated. The establishment of spaces for the full operation of the automatic fiscal stabilizers in periods of recession would provide a further instrument for securing a more stable monetary policy. The combined impact of monetary measures and the

above-mentioned stabilizers should normally be enough to relieve transitory situations of recession (European Commission, 1997). As already noted, the efficacy of these policies depends to a large extent on the initial conditions, which is why it is so important to seek mechanisms that ensure dynamic consistency.

The Stability and Growth Pact was a significant advance in this direction. It establishes medium-term objectives in terms of balanced or surplus fiscal positions, and binds its members to present three-year stabilization programmes which specify how these objectives are to be attained. This combination of medium-term goals with annual follow-ups of the measures applied could be a very useful example for the Latin American countries, which are just beginning to address the question of macroeconomic coordination in the context of integration agreements.

In Latin America, countries have been unwilling or unable to use fiscal policy as a counter-cyclical tool. When countries are in recession, their main concern is to control episodes of financial insolvency, while in boom periods they tend to increase public expenditure. The automatic fiscal stabilizers must be understood in the strict sense, that is to say, as symmetrical mechanisms which operate in both phases of the cycle. Rather than defining the cycle precisely, it is necessary to recognize the close links between public income and expenditure, on the one hand, and the level of activity on the other, accepting a certain amount of deficit in exceptional circumstances but limiting it to a certain maximum level. This ensures sustainability over time, while at the same time maintaining enough flexibility to deal with situations of recession without making excessive adjustments.

If the condition of convergence of the effective GDP and the potential GDP is fulfilled in the medium term and the automatic stabilizers are allowed to operate symmetrically, the balance will average zero for the cycle and the country will retain its capacity to contract debt to deal with unforeseen situations. In this context, it is important to establish maximum limits for the deficit, with provision for cyclical fluctuations and some degree of fiscal discretionality. It does not seem desirable to fix strict annual numerical criteria, but rather ranges of values which ensure that the basic principles of policy management listed earlier are respected. A realistic attitude calls for the maintenance of some flexibility in economic policy

in order to keep open the possibility of intervention in an uncertain environment.

Active intervention policies may be arbitrary, with a possible bias towards excessive intervention, exaggerated public expenditure or deficits that it is hard to keep under control. Asymmetrical fiscal policies are not sustainable, giving rise to well-known consequences as regards economic/political cycles and/or the build-up of imbalances. Either for intellectual reasons or on the grounds of experience, many analysts tend to reject the model based on discretionary intervention because of the dangers of populism and fiscal irresponsibility that it involves. It seems desirable that outside limits should be established or that Congress or other State bodies should control possible excesses in the management of public expenditure and tax rates, in order to avoid potentially destabilizing fiscal cycles.

It is thus desirable to have mechanisms that ensure the consistency of fiscal policy, such as tax revenue stabilization funds (ECLAC, 1998). Compensatory mechanisms like these make it possible to save transitory income during boom periods and use it later to stabilize expenditure in times of crisis, thus helping to keep the public accounts "out of the red" by injecting the accumulated income into the budget when income is lower than expected and acting as automatic stabilizers of expenditure, thus avoiding the continuous "stop and go" syndrome in fiscal management; they also have the advantage of reducing the political costs of the cyclical deficit, since the way the system operates will be more transparent and will limit the inevitable debates on the budget in Parliament. Such funds would be built up with tax surpluses not foreseen in the budgets officially adopted during the period in question, and would be used when conditions become adverse.

Ireland has an emergency fund equivalent to 0.7% of GDP in order to deal with changes in the prevailing conditions (Ford, 1998). In Argentina, the 1999 Fiscal Responsibility Law included the establishment of the Fiscal Counter-cyclical Fund, which can be used to help out the regular budget in recessions which amount to three percentage points of GDP or more. The resources of the Fund cannot be used to finance permanent increases in current expenditure. In other countries, such a fund could be smaller, if the objective is to establish automatic mechanisms to soften macroeconomic fluctuations. The estimated impact of the economic cycle on the

budget for a GDP gap of 5%, a tax rate of 20% and an income-elasticity of taxes of 1 is one percentage point of GDP. It does not appear to be necessary to build up large amounts of reserves, but rather to ensure the continuity of public programmes, at least within the annual budget cycle.

In addition to the role of the traditional automatic stabilizers, an expenditure budget programmed for several years and less sensitive to short-term fluctuations would heighten the stabilizing impact of the public finances during the cycle and would undoubtedly increase the efficiency of public expenditure. As noted in a forthcoming ECLAC document: "the management of public expenditure should be governed, on the one hand, by clear criteria of long-term stability, especially in the case of operating expenditure. Its main counter-cyclical component should be social safety nets. Consequently, these safety nets, together with public revenue stabilization funds, should be the basic instruments for the counter-cyclical management of the public finances during the economic cycle".

Because of the weakness of the institutional machinery for social protection in Latin America, in some cases the operation of the automatic stabilizers alone might not be sufficient: in this event, it might be necessary to increase public employment or transfers discretionally. The thought of deficits or increases in public expenditure or transfers during period of recession might cause cold shivers, but what is needed is to prepare efficient plans of high social profitability which can absorb at least a significant part of cyclical unemployment. The mechanisms for this must be of a transitory nature, in order not to endanger the progress already made, and should be backed by the necessary political consensus in situations of excessive unemployment. In such cases, rather than trying to stimulate demand by reducing taxes, fiscal policy should seek ways of expanding demand through expenditure on public investment or incentives for private investment in infrastructural sectors.

If some degree of transitory deficit is accepted, subject to the commitment to generate a corresponding surplus later, or if there is a tax stabilization fund, programmes of this type would be sustainable. Suitable instruments for this purpose should combine various characteristics, such as being reversible and being capable of rapid intervention, in order not to act too late and thus have a pro-cyclical effect on

GDP. Such interventions call, on the one hand, for banks of duly evaluated projects, in order to avoid faulty resource allocation which would prejudice long-term growth, and on the other for due coordination with the decentralized agents responsible for making the investments. It must also be borne in mind that direct or indirect measures to stimulate demand produce their effects on the economy with a lag which is difficult to estimate, so that there is a danger of over-reaction.

Quite apart from complying with numerical objectives regarding the balance, a more active fiscal policy can help to regulate the short-term situation more effectively. In order for macroeconomic management to be efficient (especially when there are different types of disturbances), a growing consensus on taxation must be achieved among the economic agents, which means that instruments must be available for reducing private and public expenditure in conditions of excess demand. Such instruments could include taxes on households and companies and the fiscal adjustment itself.

Tax instruments can be used to check oscillations in private expenditure if the authorities have some degree of freedom to fix tax rates. Some interesting proposals have been made to establish ranges of permissible tax rates by law, so that the rates actually applied can be varied according to the current conditions. There may, however, be a dangerous temptation for the authorities to keep the rates always at their highest level in order to cover expenditure or achieve a surplus. In practice it has been very difficult to reach an agreement between the Executive and the Legislature on how to use tax rates efficiently for the purpose of stabilization. Although these rates are the most powerful instrument for managing the evolution of private expenditure directly and efficiently, they are only used to a very limited extent in Latin America.

The idea of flexible taxes is an attractive concept and would aid in macroeconomic management, but its application raises many problems. Thus, for example, if the flexible tax is the Value Added Tax (VAT) –say, in a range between 16 and 20%– its downward rigidity could be enormous as long as such strict deficit targets as those currently existing in Latin America are maintained. In other words, it may be very difficult to explain why a reduction in taxes is necessary when there is a risk that the public balance may deteriorate in a situation of recession or

why tax rates should be raised when there is a surplus in the upper part of the cycle.

From a macroeconomic viewpoint, management of personal income taxes withheld at source is the best instrument for short-term regulation. But how can this be explained to the few wage-earners who are subject to such taxes, who would bear the whole burden of the adjustments and whose take-home pay would vary from month to month? In these circumstances, consensus on taxation would be achieved with greater horizontal and vertical equity by broadening the tax base and reducing evasion. Flexible tax policies are only justifiable when tax collection ceases to be concentrated on only a few taxpayers. At present, it would seem to be simpler to progress in the direction of the establishment of stabilization funds or the creation of longer-term debt instruments. As already noted, expenditure is used much more than taxes as a counter-cyclical instrument. Furthermore, a temporary increase in expenditure on public employment or transfers would seem to have less regressive effects on income distribution than the (transitory?) reduction of taxes for the middle or high income deciles.

One of the main questions with regard to fiscal policy, as noted earlier, is the need for a clear separation between the transitory and permanent components of the public finances. The economic evolution of the Latin American countries in the 1990s has clearly shown once again that fluctuations due to events which are transitory or not sustainable in the medium term have played a dominant role in the performance of the public accounts. The challenge is to design instruments which guide the budget process towards a state of discipline with flexibility in which the transitory factors are clearly identified and which ensures a form of management consistent with the indispensable “fiscal covenant” required by society in the region (ECLAC, 1998).

Fiscal policy offers a powerful instrument for counteracting the temptation to apply expansive policies in boom periods and recessionary ones in times of crisis. In the words of Ocampo (1999): “paying too much attention to crisis management ignores a fact which ought to be evident: that national authorities’ freedom of action is greater in booms than in crises”. As the same author goes on to say: “national policies for coping with vulnerability should therefore be aimed at reducing the impact of domestic macroeconomic cycles, reducing expansionary pres-

asures on expenditure in boom periods, adopting monetary and fiscal policies and arrangements for the supervision and prudential regulation of financial systems which have the same effect, and avoiding the tendencies to exchange rate appreciation generated by an abundance of external resources”.

Rules may be defined as formal, observable restrictions on the behaviour of the economic authorities which should remain in force for a substantial period of time and involve substantial changes in conditions. In managing economic policies in general and fiscal policies in particular, imposing deterministic rules in a stochastic world can only mean introducing unnecessary rigidities. In contrast, a policy which retains a certain degree of discretion within the context of explicit rules (“rule-based discretion”), which seeks to ensure the application of counter-cyclical rules in normal times but maintains

the capacity to respond to unexpected situations, can improve global macroeconomic performance and prevent harmful fluctuations. We could think in terms of developing an increasingly “prudential” style of economic policy management (Boyer, 1999), with a form of management which is relatively autonomous but governed by explicit and socially agreed rules so as to minimize systemic risks, integrate positive and negative externalities, and facilitate policy coherence and coordination among the different powers. It must not be forgotten that the economic policy objectives in terms of inflation and unemployment form a public policy of the greatest importance and that it is therefore necessary to stimulate at this level too a style of management based on results which includes among its features transparency, responsibility and clear mechanisms for rendering accounts.

III

Estimation of the potential GDP

Economic policy management is inconceivable without proper distinction between trends and cycles. This distinction makes it possible to analyse the evolution of most of the macroeconomic aggregates, such as inflation, employment, the external deficit and the public deficit. In order to take decisions it is essential to be able to discriminate between the conjunctural component of a phenomenon, whose effects will go away with the return of the level of activity to its trend path, and the structural component, which is permanent and therefore calls for specific policies. Thus, in order to identify transitory phenomena, such as a temporary rise in the rate of inflation, a change in cyclical unemployment, a transitory increase in the external deficit or an increase in the cyclical public deficit, it is necessary to have a point of reference, a medium-term horizon which we may call “normality”. The old concept of the product gap, defined as the distance between the effective GDP and its normal level, represents a simple summary measure of the position of the economy in the cycle. For this reason, it is frequently used by empirical economists, and a large variety of methods have been proposed for making a diagnosis of the

position of the economy with respect to its growth potential.

This exercise is no trivial matter, especially in the Latin American countries. The question as to the potential growth of the economies of the region has given rise to various answers, ranging from near-euphoria to excessive pessimism. In view of the extraordinary volatility of the economies of the region, the task of identifying a medium-term path and then taking decisions in the light of that abstract concept might seem a complex and even useless exercise in periods of great turbulence and upsets, but it nevertheless contains an undeniable fact: that all agents, both public and private, need a medium-term horizon in order to take their decisions in a rational manner and thus provide suitable conditions for raising the potential growth rate.

Because of the importance of this matter –as Barrell and Sefton (1995) noted, in view of its importance it is a pity that the product gap cannot be measured directly– most international agencies and national planning bodies of the industrialized countries which engage in macroeconomic analysis publish their own estimates of the potential product of

those countries.³ This is not the case in Latin America, for at least three reasons. The first of these is economic: the degree of volatility has been so great in recent decades that it is very difficult to identify the economic cycle (in graphical terms, the evolution of GDP resembles a roller coaster rather than a landscape of gently rolling hills). The second is political: the concept of the potential product (the growth that could be achieved in view of the evolution of the global productivity of the factors of production) is often confused with a voluntaristic objective (the growth that needs to be attained in order to take care of social demands and reduce poverty, for example). The third reason is ideological: many analysts believe that economic reforms such as greater openness, privatization and reform of the labour market will raise the potential GDP, although in reality the restrictions have much more to do with difficulties in expanding the production frontier: excessive sluggishness of the capital accumulation process, slow spread of technical progress, and consequent stagnation of the global productivity of the factors of production.

This is why this exercise seems particularly important for the Latin American countries. In the final analysis, the potential GDP cannot depart much from the trend GDP (the two variables converge in the medium term), so that the estimation and use of the latter in taking decisions represents in itself an advance towards prudent management of fiscal and monetary policies. Ultimately, a sustainable growth rate cannot be very different from the average for recent years, and this should be reflected in the monetary and fiscal planning of the public authorities.

The potential product may be defined as the maximum level of product that can be sustained on a lasting basis without causing tensions in the economy and, more precisely, without causing inflation to speed up (Le Bihan, Sterdyniak and Cour, 1997). Thus, the potential product corresponds to the level of activity compatible with stable inflation. It may be defined as an indicator of aggregate supply, in a normal growth path, with a NAIRU-type natural unemployment rate (*non-accelerating inflation rate of unemployment*) and without situations of excess or

insufficient demand or the consequent inflationary or deflationary pressures. The growth rate of the economy would be constantly at "cruising speed", with a stable rate of utilization of the capital and labour factors and a constant interest rate. The product gap (GAP) is simply the difference between the effective GDP (Y) and the potential GDP (Y^*), and the relation between the two may be written as follows:

$$GAP = \frac{Y - Y^*}{Y^*} \quad (2)$$

As the level of the potential product is an indicator of supply, the product gap represents the excess or insufficiency of aggregate demand, thus giving an indicator of the position of the economy in the cycle. In this sense, the potential GDP may be assimilated to the recent past performance registered in the trend GDP: the two variables converge in the medium term. It is also important to distinguish the potential GDP from the natural or optimum GDP, or the GDP at flexible prices, which may be defined as the maximum level of product attainable if the distortions in the economy due to the existence of positive marginal tax rates or imperfect markets are eliminated. This distinction is of fundamental importance: macroeconomic policy seeks to guide the economy in the short and medium term towards its trend GDP path and not towards its optimum level of flexible prices. To obtain the latter it is necessary to make structural reforms designed to improve the efficiency of markets by stimulating competition and reducing the rigidities associated with the process of fixing prices and nominal wages.

There are various methods of a statistical (trend adjustment, movable averages, Hodrick-Prescott filter) or structural nature (aggregate production functions) for estimating medium-term growth.⁴ The statistical methods define potential growth by calculating a past production trend, assuming that the observed GDP fluctuates around the potential GDP and that the latter can be evaluated as the observed trend GDP.

The most traditional way of calculating the trend GDP is by adjustment of the product logarithm over a linear trend. In this case, the trend and potential growth is constant and identical with the average

³ *World Economic Outlook*, of the International Monetary Fund; *Economic Perspectives*, of the Organization for Economic Cooperation and Development; *European Economy*, of the European Commission, and other estimates by the central banks and ministries of finance of the industrialized countries.

⁴ For an appraisal of the various methods, see Giorno, Richardson, Roseveare and Van de Noord (1995).

growth during the estimation period. In long series the observed growth rate has many points of change, however, so the segmented trends method is usually used instead. This method has the following stages: i) identification of past cycles; ii) estimation of the successive average growth rates for each cycle; iii) definition of a rule for the calculation of this average growth rate for the current cycle, and iv) calculation of the GDP gap from the difference between the observed series and the estimated series of average GDP levels. The potential GDP is estimated by means of a simple regression between the effective GDP and the trend variable; the cyclical component is simply the remainder of this equation.

The problem with this method is that it imposes a deterministic trend which does not provide for the occurrence of structural breaks within each cycle. It is generally accepted, however, that the GDP trend has stochastic and not only deterministic components. It is assumed that structural breaks in aggregate supply, although discrete, represent disturbances that have permanent effects. Consequently, as it confuses potential growth with average growth, a linear representation of the GDP gap does not appear to be a suitable description when the economy is subject to continual supply disturbances.

The Hodrick-Prescott (HP) filter, in contrast, seeks to identify the stochastic component of the trend by adjusting a series which varies over time without the need to define the structural break points. It estimates a trend which simultaneously minimizes a weighted average of the variance in the gap between the GDP and the trend GDP and the change in the growth rate of the trend GDP. The trend Y^* for $t = 1, 2, \dots, T$ is estimated by solving the following minimization problem:

$$\begin{aligned} \text{Min} \quad & \sum_{t=1}^T (\ln Y_t - \ln Y_t^*)^2 + \\ & \lambda \sum_{t=2}^{T-1} [(\ln Y_{t+1}^* - \ln Y_t^*) - (\ln Y_t^* - \ln Y_{t-1}^*)]^2 \end{aligned} \quad (3)$$

where λ is the weighting factor controlling the degree of smoothing of the trend curve obtained. A small value of λ gives a series close to the original (if $\lambda = 0$, then the two are identical), while a high value of λ reduces the sensitivity of the trend to fluctuations in the effective GDP (if $\lambda = \infty$, the trend

merges with the average growth rate of the effective GDP series). The value of the multiplier λ defines the number of years included in the weighted movable average: if its value rises, so too does the weight of the most distant years in the estimation of the trend GDP.

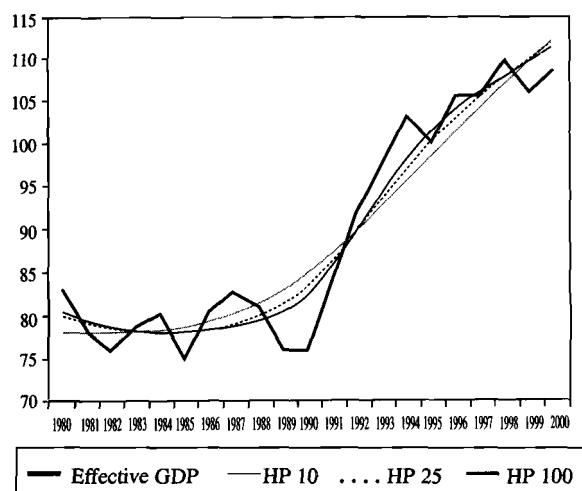
The problem is that an arbitrary value is assigned to λ , which determines the variance of the trend GDP estimation. The variance of the trend GDP falls as λ rises, and the size of the GDP gap thus increases. Hodrick and Prescott (1997) recommend values of $\lambda = 1600$ for quarterly series and $\lambda = 100$ for annual series. The empirical studies dealing with international comparisons use various values ranging from $\lambda = 100$ (Ongena and Roger, 1997) to $\lambda = 25$ (Giorno, Richardson, Roseveare and Van de Noord, 1995), $\lambda = 10$ (Doménech, Gómez and Taguas, 1997) and even $\lambda = 6.5$ (Pedersen, 1998). So far, there are no satisfactory statistical tests that make it possible to identify which trend-cycle breakdown is better than others. The selection criteria are not very clear: the main thing is to select a value of λ which generates cycles similar to those estimated with other methods (Giorno, Richardson, Roseveare and Van de Noord, 1995). The same value is generally chosen for all countries.

The Hodrick-Prescott filter is a symmetrical operator, similar to a movable average, and the GDP gap therefore comes to zero over the estimation period as a whole. Furthermore, GDP gaps are smaller in relative terms when estimation of production functions, for example, is used in the comparison. A classic problem of these filters arises when the behaviour of the starting and finishing points is not like the other observations in the cycle, so that the trend is stuck to the initial and final observations. Thus, for example, if there is less growth in the last year of the series the filter will underestimate the potential GDP for that year. The solution to this problem would be to make "reasonable" growth projections for two or more years. In our case, the results are presented with a lag of one year.

Series were available for twelve countries of the region,⁵ obtained from the GDP calculated by ECLAC for the period 1980-1998, the estimated GDP for 1999, and the projected GDP for the year 2000

⁵ Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Ecuador, Mexico, Paraguay, Peru, Uruguay and Venezuela.

FIGURE 2

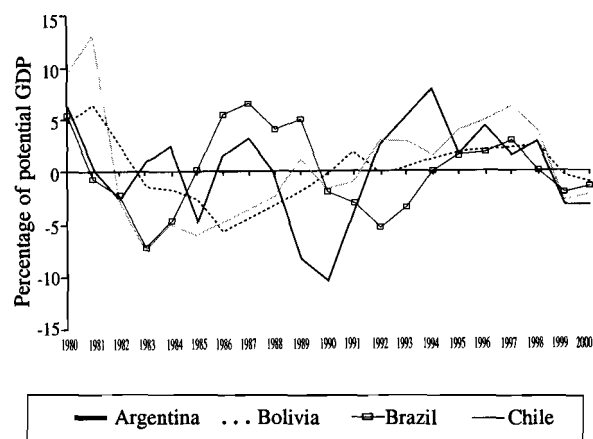
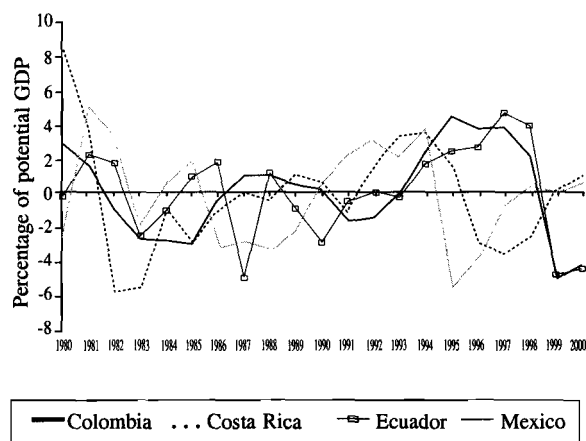
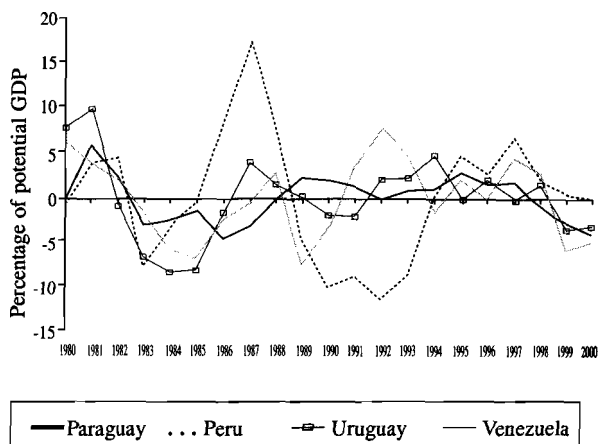
Argentina: Estimation of potential GDP for different values of λ


(ECLAC, 1999a and b). In order to give greater stability to the estimates for the end of the period, we generally try to close the gap in the projection period, assuming for this purpose that all the countries grow at the rate of 5% in 2001 and 2002.

The sensitivity analyses show that the value obtained for the GDP gap is quite uneven in the countries where there was the greatest variability. Figure 2 shows the GDP gap for Argentina, for different values of the parameter λ , and the differences are very marked. Thus, for example, in 1990 the GDP gap fluctuated between -10.5% for $\lambda = 100$ and -7.8% for $\lambda = 10$: a distance of over 25% between the two estimates. It is well known, of course, that any statistical estimation method has a very high degree of uncertainty. In order to facilitate the comparative analyses, we chose a value of $\lambda = 100$ for all the countries, as the European Commission does. It may be recalled that these calculations are the accepted reference values for all the signatories of the Stability and Growth Pact.

Let us now look at the results obtained for the GDP gap in the twelve countries in question (figure 3). This gap has fluctuated markedly in some Latin American countries: in the 1980s it varied between -11% and +17% in Peru, and in the 1990s it fluctuated between -10.5% and +7.5% in Argentina, contrasting with absolute values that rarely exceed 4% of the potential GDP in the industrialized countries (Buti, Franco and Ongena, 1998). This indicator is a

FIGURE 3

Latin American countries: GDP gap
A. Argentina, Bolivia, Brazil and Chile

B. Colombia, Costa Rica, Ecuador and Mexico

C. Paraguay, Peru, Uruguay and Venezuela


valuable instrument for identifying potential imbalances in the goods market, which show up first in the trade account and later in the prices of non-tradeable goods, and as an advance indicator it is useful for identifying episodes of excess demand which could foretell future inflationary pressures on the one hand and external sector imbalances on the other.

The GDP gap is calculated on the level of the trend GDP, with a filter which is similar to a movable average, is symmetrical and incorporates lags; consequently, cycles of excess demand or supply can last as long as seven years. The symmetrical nature of the filter is crucial when evaluating the GDP gap. The Chilean case is instructive in this respect. After uninterrupted growth at an average rate of 7% per year between 1990 and 1997, the 1998 slowdown and the subsequent fall in 1999 reduced the trend GDP. Thus, looking back, there was a positive GDP gap between 1991 and 1997 which symmetrically offsets the negative GDP gap of the years 1999 and 2000. Consequently, the period which was defined as "normal" was really a prolonged but transitory boom. It will be recalled that, with the Hodrick-Prescott filter, discrete breaks represent disturbances which have permanent effects. As already noted, it is not wise to confuse potential growth with average past growth without taking into account discrete episodes when the economy is subject to continual disturbances in supply. This means that the episode of recession is not neutral in the evaluation of future growth, so it is necessary to lower the estimate for the years to come.

The great virtue of the Hodrick-Prescott filter for generalized application in non-stationary time series is its simplicity. Many authors criticise the method because it does not involve estimation but rather an arbitrary separation between trend and cycle, without taking into account the properties of the series being studied. Furthermore, the estimation of the potential GDP does not incorporate any economic

structure, thus seriously limiting its use as an indicator of imbalances in the goods market. As an alternative to univariate estimation techniques, the method for estimation of an aggregate production function relates the potential GDP with the total productivity trends of the factors and the amounts of labour and capital used in the production process. As this filter is generally used to calculate exogenous technical progress and other elements of the production function, however, in practice the estimates turn out to be quite similar (European Commission, 1995).

A "third way" is to use semi-structural methods, like those used by the Central Bank of New Zealand (Conway and Hunt, 1997). The idea is to use a multivariate filter which uses the information contained in some macroeconomic relations to identify the variations in GDP which are attributable to disturbances in supply and demand. These authors enhance the Hodrick-Prescott filter with information on a Phillips curve, Okun's Law, and a measure of the degree of utilization of installed capacity. To be more precise, they use the remainders of these three relations (between expected inflation and the GDP gap, between deviations of unemployment from its trend and deviations of GDP from its trend, and between deviations of the degree of utilization of installed capacity from its trend and the GDP gap) to calibrate a filter which makes it possible to identify disturbances in supply and demand. Although it is an interesting proposition, this methodology suffers from some weak points, such as the difficulty in determining the relative weight of each macroeconomic relation in the evolution of potential GDP and the greater demands in terms of information, especially when making comparisons between countries. In spite of its limitations, the Hodrick-Prescott filter seems an adequate solution if what is sought is an elementary and immediate measure of macroeconomic fluctuations which will make it possible to identify a "normal" horizon.

IV

The magnitude of the automatic fiscal stabilizers in Latin America

Variation in a component of public income or expenditure is cyclical when it is due to the difference between the observed product and the trend product. In the OECD methodology (Giorno, Richardson, Roseveare and Van de Noord, 1995), the deficit is broken down into a cyclical component and a structural one. The GDP gap is calculated as a percentage of the potential GDP, so that the cyclical balance is positive when the effective GDP is greater than the trend GDP and negative when it is smaller than it. Expressed as a percentage of GDP, the structural deficit is obtained from the difference between the global deficit and the cyclical deficit. The idea is that the structural or discretionary deficit constitutes a suitable indicator of the fiscal thrust: that is to say, the direction fiscal policy is taking.

In the case of many Latin American countries, this information is not enough, because there are many sources of non-tax income, ranging from the profits of public enterprises that export commodities to the income from privatization operations; furthermore, the variation in tax income is also due to other variables, such as inflation. For this reason, the concept of the structural deficit, as defined earlier, may not be a good indicator of the thrust of fiscal policy. Hereinafter, we will use "structural deficit" to refer to an indicator which could be described more exactly as the deficit "corrected for the influence of cyclical fluctuations in the level of activity". Nonetheless, fixing deficit targets which are independent of other short-term oscillations (such as commodity prices) is of prime importance. It is also necessary to define what is "normal" for these forms of non-tax income.

A decisive element in analysis of the magnitude of the automatic fiscal stabilizers is the weight of tax income in the economy and in the total resources of the public sector. In 1997, tax revenue of the non-financial public sector represented between 17 and 20 points of GDP in Argentina, Chile, Colombia, Uruguay and Costa Rica; between 12 and 14 points in Bolivia, Peru and Paraguay, and close to 10 points

in Venezuela, Mexico and Ecuador (table 1). In the last three countries, as also in Bolivia, tax revenue of that sector did not amount to even half of its total income. In Argentina, Chile, Colombia, Peru and Uruguay, in contrast, the proportion was much higher. Brazil is a special case: in 1997, tax revenue of the non-financial public sector was equivalent to 25 points of GDP, and this figure has now risen to nearly 30 points.

Once we know the relation between tax income and the GDP, all that is needed to obtain this breakdown is to estimate the income elasticity of taxes. The OECD indicator of discretionality breaks down taxation into its main components (taxes on goods and services, on companies and on households) and econometrically estimates the respective income elasticities, whose values depend basically on the tax structure and the progressiveness of the system. Table 2 shows these values as estimated by the OECD for some of its member countries. The income and profits of enterprises are very sensitive to the level of activity, which explains the high elasticity of revenue from taxes on companies, ranging from 2.4 to 4.5, depending on the country. Although the table shows total elasticity, the importance of the lags between the operations subject to tax and the actual collection of the tax should be noted. This means that the short-term or spot elasticity is much less than the long-term elasticity in the case of taxes on companies. The income elasticity of taxes on households, for its part, depends on the progressiveness of the system. The OECD estimates range from 0.4 to 1.4, with a simple average of 0.9.

In contrast, it may be assumed that indirect taxes have an elasticity of one (instantaneous). In reality, the elasticity of VAT, for example, depends on the breakdown of private consumption between durable and non-durable goods (in a recession, consumption of durable goods goes down more sharply and the elasticity of VAT with respect to total consumption is therefore greater than unity at such times, if there are differentiated tax rates); on the elasticity of the vol-

TABLE 1

Latin America (12 countries): Tax income and total income of the non-financial public sector, 1997
(Percentages)

	Percentages of GDP		B as a percentage of A
	A. Total income	B. Tax income	
Argentina	17.2	17.0	98.84
Bolivia	30.3	14.0	46.20
Brazil	28.9	24.8	85.81
Chile	33.5	19.4	55.94
Colombia	33.6	19.5	58.04
Costa Rica	29.8	16.5	55.37
Ecuador	23.8	9.1	38.24
Mexico	23.0	9.8 ^a	42.61
Paraguay	21.1	11.8 ^a	55.92
Peru ^a	14.2	12.0	84.51
Uruguay	32.0	18.4	57.50
Venezuela	31.9	10.1	31.66
<i>Total Latin America and the Caribbean</i>	<i>23.3</i>	<i>13.9</i>	<i>53.46</i>

Source: ECLAC, on the basis of official figures (see ECLAC, 1999a).

^a Refers to central government.

TABLE 2

Organization for Economic Cooperation and Development (7 countries): Elasticity with respect to GDP

	Taxes on companies	Taxes on households	Indirect taxes	Social security contributions	Current expenditure
United States	2.5	1.1	1.0	0.8	-0.1
Japan	3.7	1.2	1.0	0.6	-0.1
Germany	2.5	0.9	1.0	0.7	-0.2
France	3.0	1.4	1.0	0.7	-0.1
Italy	2.9	0.4	1.0	0.3	-
United Kingdom	4.5	1.3	1.0	1.0	-0.1
Canada	2.4	1.0	1.0	0.8	-0.3
Simple average	3.1	0.9	1.0	0.7	-0.1
Euro Zone	1.2	1.0	1.0	0.8	-0.2

Source: Giorno and Suyker (1997) for the countries and OECD (1999) for the Euro Zone.

ume of imports with respect to GDP (if this elasticity is greater than unity, the VAT collected on imported goods grows more rapidly than GDP; and on the relation between tax evasion and the economic cycle: aspects which are not usually taken into account in comparative analyses but which can be highly significant in some situations. Many of the recessions in Latin America are marked by drastic external adjustments in which private consumption –and above all its imported component– falls much more than GDP.

In this case, the elasticity would be much greater than unity. These factors must be taken into account when making analyses of the sensitivity to the level of activity in each country and each situation. The income elasticity of taxes with respect to GDP is an aggregate which seeks to represent a structural parameter, but it can vary on account of the many factors that affect the tax bases, both on the side of the components of aggregate demand and on the side of income. Finally, the elasticity of social security

contributions with respect to GDP is less than unity, which shows that they are less sensitive to the economic cycle.⁶

The mean aggregate elasticity depends on the tax structure of the country. An aggregate elasticity of one is estimated for the European Union, varying from 1.38 for Great Britain to 0.77 for Italy (European Commission, 1995). In countries where direct taxes, and above all taxes on companies, predominate this elasticity will be greater than unity, but in those where indirect taxes are more important this parameter is generally close to unity, on average. This is so in the case of the Latin American countries.

Tax reforms, of which there have been many in the region in the recent past, change the rates or bases of the main taxes, thus making the econometric estimation of tax elasticities very difficult. It is important to note that the results of breaking down the deficit are less sensitive to changes in the values of these elasticities than to changes in the measurements of the GDP gap (Giorno and Suyker, 1997). For this reason, we assume an income elasticity of one for all the countries. On the expenditure side, total elasticity in the OECD countries is -0.1 on average and varies as a function of the size of the transfers provided for under the unemployment insurance legislation. These protection mechanisms are practically non-existent in Latin America, so there are virtually no expenditures or transfers automatically linked to the economic cycle. Consequently, cyclical expenditure is not taken into account in the calculations below.

The methodology adopted tends to underestimate the cyclical component, by assuming an income elasticity of taxes equal to unity for all countries. Under this hypothesis, the relative size of the cyclical deficit depends only on two factors: i) the gap between the effective and potential GDP, which measures the distance between the effective growth of the economy and its medium-term path, and ii) the weight of taxes in total public income, which represents the proportion of revenue directly linked to the level of activity.

The marginal sensitivity of the public balance to changes in the level of activity is obtained by multiplying the aggregate elasticity by the rate of taxation. Thus, for example, if the elasticity of taxes with re-

spect to GDP is one, the tax rate is 40% and the product gap is -5%, the cyclical deterioration of taxes is two points of GDP. For the average tax rates in the region, which are of the order of 20%, the cyclical balance would be one point of GDP for a GDP gap of 5% and two points for a gap of 10%. In other words, the sensitivity of the public balance to changes in the level of activity is close to 0.2 (for each percentage point of the GDP gap, the public balance varies by 0.2 points of GDP), compared with the value of 0.5 calculated for the European Union on average (Buti, Franco and Ongena, 1998). Table 3 shows the marginal sensitivity of the public balance to changes in the level of activity in some European countries (for 1995) and in Latin America (for 1997). It also shows the size of the GDP gap and the cyclical deficit, with their maximum and minimum values, for 1960-1996 in the case of Europe and 1980-1999 in the case of Latin America.

On average, the cyclical balance fluctuated between -0.5 and 0.8 points of GDP during the 1985-1996 period in the OECD countries (Giorno and Suyker, 1997) and between -1.3 and 1.6 in the European Union in the period from 1960 to 1996 (European Commission, 1997). The range of variation is enormous, with maximum and minimum values of -4.1 and 3.2 for Sweden and -1.1 and 1.6 for Italy. These differences are connected with the size of the GDP gap and the marginal sensitivity of the budget to changes in the level of activity.

In the case of the Latin American countries, the size of the estimated GDP gap is noteworthy, with minimum values close to or greater than 10% in countries such as Argentina, Peru, Chile and Uruguay, and maximum values consistently over 5% of the potential GDP. This marked volatility of the level of activity (figure 4) has adverse consequences for the public deficit, even though the marginal sensitivity of the public balance in the region is far below that of the European Union.

If we combine these two elements –tax rate and volatility of GDP– the application of this methodology to the Latin American countries (table 4) brings out a cyclical component of the deficit which was significant in the 1990s, with values close to or higher than one point of GDP in Argentina, Brazil, Chile, Colombia, Costa Rica and Peru. It therefore seems worth estimating this component in order to evaluate the public accounts results properly. In Bolivia, Paraguay, Ecuador and Venezuela, in contrast, the cyclical

⁶ Other authors, however, estimate elasticities greater than unity for social security contributions: see, for example, Boscá, Doménech and Taguas (1998).

TABLE 3

European countries and Latin America: Magnitude of the automatic stabilizers^a

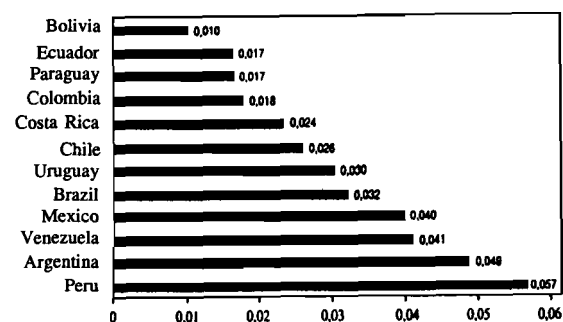
	Marginal sensitivity of public balance to GDP	GDP gap (as % of potential GDP)		Cyclical component of public balance (% GDP)	
		Minimum	Maximum	Minimum	Maximum
Sweden	0.9	-4.6 (93)	3.7 (90)	-4.1 (93)	3.2 (90)
Holland	0.8	-3.4 (83)	2.4 (74)	-2.9 (83)	1.8 (74)
Denmark	0.7	-3.6 (81)	3.8 (86)	-2.4 (81)	2.6 (86)
United Kingdom	0.6	-4.0 (82)	5.1 (88)	-2.7 (82)	3.1 (89)
Spain	0.6	-4.5 (60)	5.3 (74)	-2.1 (85)	2.7 (90)
Germany	0.5	-3.8 (67)	4.3 (91)	-1.8 (67)	2.4 (91)
France	0.5	-2.1 (85)	3.2 (90)	-1.1 (85)	1.6 (90)
Italy	0.5	-3.4 (75)	3.1 (80)	-1.2 (75)	1.1 (80)
European Union	0.5	-2.2 (83)	3.2 (73)	-1.3 (83)	1.6 (90)
Brazil	0.25	-7.3 (83)	5.5 (80)	-1.2 (92)	0.7 (80)
Colombia	0.19	-5.1 (99)	4.5 (95)	-1.0 (99)	0.9 (95)
Chile	0.19	-7.5 (83)	13.4 (81)	-1.3 (83)	2.6 (81)
Uruguay	0.18	-8.5 (84)	9.7 (81)	-1.1 (84)	1.6 (81)
Argentina	0.17	-10.5 (90)	7.5 (94)	-1.3 (90)	1.3 (94)
Costa Rica	0.16	-5.7 (82)	8.7 (80)	-0.7 (82)	0.9 (80)
Bolivia	0.14	-5.7 (86)	6.4 (81)	-0.6 (86)	0.6 (86)
Paraguay ^b	0.12	-4.5 (86)	5.7 (81)	-0.4 (86)	0.4 (95)
Peru ^b	0.12	-11.2 (92)	17.4 (87)	-1.1 (92)	1.5 (87)
Mexico ^b	0.10	-5.6 (95)	5.2 (81)	-0.5 (95)	0.6 (81)
Venezuela	0.10	-7.4 (89)	8.0 (92)	-0.6 (99)	0.5 (97)
Ecuador	0.09	-5.0 (99)	4.7 (97)	-0.5 (99)	0.4 (97)

Source: For the European countries: European Commission (1997). For Latin America: Economic Commission for Latin America and the Caribbean (ECLAC) and calculations by the author.

^a Numbers in brackets indicate year.

^b Refers to central government.

FIGURE 4

Latin America (12 countries):
Standard deviation of GDP, 1990-1999

cal component is only a little over 0.5 points of GDP. In Bolivia and Paraguay there were only moderate macroeconomic fluctuations in the 1990s, and in Ecuador and Venezuela the income from oil exports was equal to or greater than tax income. The breakdown presented here leads in some cases to a radically different interpretation of the public accounts results. In some situations, their deterioration is due to factors of a conjunctural nature rather than deliberate actions of the authorities. Thus, for example, the increase in the deficit in 1999 in Argentina was due exclusively to its conjunctural component. In this and other cases the position in the cycle conceals a structural effort to improve the public accounts.

The cyclical component is significant not only because of its importance in the annual budget but also because of its persistence over various periods. Countries such as Argentina, Brazil, Chile, Colombia, Ecuador, Paraguay, Uruguay and Venezuela reg-

TABLE 4

Latin America (selected countries): Cyclical and structural components of the non-financial public sector accounts,^a 1990-1999
(As a percentage of GDP)

Country and coverage	Variable	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999 ^b
Argentina NPS	Observed balance	-3.8	-1.6	-0.1	1.4	-0.2	-0.6	-1.8	-1.4	-1.2	-2.1
	Cyclical balance	-1.3	-0.5	0.4	0.9	1.3	0.2	0.6	0.2	0.4	-0.5
	Structural balance	-2.5	-1.1	-0.5	0.5	-1.5	-0.8	-2.4	-1.6	-2.8	-1.6
	Tax revenue	12.4	14.2	16.6	17.4	17.0	16.0	14.7	17.0	15.4	
	GDP gap	-10.5%	-3.7%	2.4%	5.1%	7.8%	1.5%	4.1%	1.3%	2.6%	-3.4%
Bolivia NFPS (operational)	Observed balance	-4.5	-4.3	-4.4	-6.1	-3	-1.8	-2	-3.4	-4.0	-4.2
	Cyclical balance	-	0.1	-	-	0.1	0.2	0.2	0.2	0.3	-0.1
	Structural balance	-4.5	-4.4	-4.4	-6.1	-3.1	-2.0	-2.2	-3.6	-4.3	-4.1
	Tax revenue	7.3	7.6	9.5	10.3	10.4	11.5	12.1	12.8	14.0	
	GDP gap	-0.4%	1.7%	-0.1%	0.3%	1.0%	1.6%	2.0%	1.9%	2.4%	-0.7%
Brazil NFPS	Observed balance	1.4	-0.2	-1.8	-0.8	1.1	-5.2	-3.8	-4.3	-7.5	-8.5
	Cyclical balance	-0.5	-0.7	-1.2	-0.8	-	0.4	0.4	0.7	-	-0.6
	Structural balance	1.9	0.5	-0.6	-	1.1	-5.6	-4.2	-5.0	-7.5	-7.9
	Tax revenue	25.0	21.5	21.5	22.7	25.2	25.3	24.6	24.8	26.7	
	GDP gap	-2.1%	-3.1%	-5.5%	-3.5%	-0.1%	1.4%	1.6%	2.7%	-0.1%	-2.3%
Chile NFPS	Observed balance	1.3	1.7	2.7	2.2	2.1	2.7	1.8	0.9	-0.8	-1.5
	Cyclical balance	-0.3	-0.2	0.5	0.5	0.2	0.7	0.9	1.1	0.7	-0.6
	Structural balance	1.6	1.9	2.2	1.7	1.9	2.0	0.9	-0.2	-1.5	-0.9
	Tax revenue	15.7	17.8	18.6	19.5	18.8	18.4	19.7	19.4	19.2	
	GDP gap	-1.8%	-1.1%	2.8%	2.7%	1.2%	3.8%	4.7%	5.9%	3.6%	-2.9%
Colombia NFPS	Observed balance	-0.5	0.2	-0.2	0.1	1	-0.6	-2	-3.1	-3.4	-4.6
	Cyclical balance	-	-0.3	-0.2	-	0.5	0.9	0.7	0.7	0.4	-1.0
	Structural balance	-0.5	0.5	-	0.1	0.5	-1.5	-2.7	-3.8	-3.8	-3.6
	Tax revenue	14.9	16.2	16.9	19.1	19.4	19.6	19.2	19.5	20.1	
	GDP gap	0.2%	-1.7%	-1.5%	-%	2.5%	4.5%	3.6%	3.7%	2.0%	-5.1%
Costa Rica NFPS	Observed balance	-2.5	-0.1	0.7	0.6	-6.6	-2	-2.7	-1.5	-1.1	
	Cyclical balance	0.1	-0.2	0.3	0.5	0.5	0.2	-0.5	-0.6	-0.5	-
	Structural balance	-2.6	0.1	0.4	0.1	-7.1	-2.2	-2.2	-0.9	-0.6	
	Tax revenue	14.0	14.4	15.1	15.4	14.7	15.7	16.4	16.5	17.0	
	GDP gap	0.6%	-1.2%	1.7%	3.3%	3.5%	1.5%	-3.0%	-3.7%	-2.7%	-0.1%
Ecuador NFPS	Observed balance	0.1	-0.6	-1.2	-0.1	-0.2	-1.4	-3.1	-2.6	-6.2	-4.0
	Cyclical balance	-0.2	-	-	-	0.1	0.2	0.2	0.4	0.4	-0.5
	Structural balance	0.3	-0.6	-1.2	-0.1	-0.3	-1.6	-3.3	-3.0	-6.6	-3.5
	Tax revenue	7.5	7.4	7.1	7.4	7.7	8.6	7.2	9.1	9.8	
	GDP gap	-2.9%	-0.5%	-%	-0.3%	1.7%	2.4%	2.6%	4.6%	3.9%	-5.0%
Mexico NFPS	Observed balance	-2.8	3.3	1.6	0.7	-0.3	-0.2	-0.1	-0.6	-1.2	-1.3
	Cyclical balance ^c	0.1	0.3	0.4	0.2	0.4	-0.5	-0.3	-0.1	-	-
	Structural balance	-2.9	3.0	1.2	0.5	-0.7	0.3	0.2	-0.5	-1.2	-1.3
	Tax revenue ^c	11.5	12.0	12.4	11.4	11.3	9.2	8.9	9.8	10.5	
	GDP gap	0.5%	2.1%	3.1%	2.0%	3.7%	-5.6%	-3.9%	-0.9%	0.3%	-0.1%
Paraguay NFPS	Observed balance	5.2	2.9	0.1	1.2	2.4	2.5	1.7	0.5	0.2	-1.5
	Cyclical balance ^c	0.2	0.1	-	0.1	0.1	0.4	0.2	0.2	-0.1	-0.3
	Structural balance	5.0	2.8	0.1	1.1	2.3	2.1	1.5	0.3	0.3	-1.2
	Tax revenue ^c	9.5	9.4	9.3	9.3	10.7	12.2	11.6	11.8	11.1	
	GDP gap	2.1%	1.3%	-%	1.0%	1.2%	3.1%	1.8%	2.0%	-0.7%	-2.7%

TABLE 4 (Concluded)

Country and coverage	Variable	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999 ^b
Peru CG	Observed balance	-2.1	-1.5	-1.5	-1.5	2.9	-0.6	-1.5	-0.8	-0.9	-2.6
	Cyclical balance	-0.8	-0.8	-1.1	-0.8	-	0.6	0.3	0.8	0.3	0.1
	Structural balance	-1.3	-0.7	-0.4	-0.7	2.9	-1.2	-1.8	-1.6	-1.2	-2.7
	Tax revenue	7.9	8.8	9.6	9.8	11.1	11.5	12.0	12.0	12.0	
	GDP gap	10.0%	-8.8%	11.2%	-8.6%	0.4%	4.9%	2.9%	6.9%	2.3%	0.7%
Uruguay NFPS	Observed balance	0.3	1.3	1.4	-0.8	-2.4	-1.3	-1.1	-1.3	-0.5	-2.5
	Cyclical balance	-0.3	-0.3	0.4	0.4	0.8	-	0.4	-0.1	0.3	-0.6
	Structural balance	0.6	1.6	1.0	-1.2	-3.2	-1.3	-1.5	-1.2	-0.8	-1.9
	Tax revenue	15.9	16.5	16.5	16.5	16.4	15.7	15.9	18.4	18.6	
	GDP gap	-1.9%	-1.9%	2.3%	2.4%	5.0%	0.1%	2.3%	-0.3%	1.7%	-3.2%
Venezuela NFPS	Observed balance	0.1	-2.2	-5.9	-1.3	-13.8	-6.8	7.2	2.6	-6.6	-4.0
	Cyclical balance	-0.1	0.2	0.4	0.3	-0.1	0.2	-	0.5	0.3	-0.6
	Structural balance	0.2	-2.4	-6.3	-1.6	-13.7	-7.0	7.2	2.1	-6.9	-3.4
	Tax revenue	4.0	4.6	5.0	5.8	8.8	9.2	8.7	10.1	11.0	
	GDP gap	-3.6%	3.7%	8.0%	4.9%	-1.3%	2.3%	-	4.8%	3.0%	-5.6%

Source: For public sector and tax revenue figures: ECLAC, on the basis of official data. For the GDP gap: calculations by the author, on the basis of ECLAC data, in 1995 dollars.

^a NPS = national public sector. NFPS = non-financial public sector. CG = central government.

^b The cyclical balance is obtained by multiplying the tax rate of the preceding year by the GDP gap. The values for the observed balance are naturally preliminary values.

^c Refers to central government.

istered declines in their GDP in 1999 and hence strongly negative GDP gaps and cyclical balances. These were offset in some cases by a positive cyclical balance in previous years (since 1992 in Argentina and Chile and since 1994 in Colombia and Brazil): the condition of symmetry applied in these calculations should be borne in mind.

The reading of the results obtained is simple: in general terms, the cyclical component is seen to be an important factor in the improvement in the public accounts in the latter part of the 1990s. In many countries the reactivation of the economy at rates above the medium-term trend values led to positive fiscal results, although these were partly due to transitory resources. The 1999 recession is a factor

which clearly shows the difficulty of establishing a "normal" horizon. For example, three or four boom years in succession tend to foster the perception of a higher growth potential, prompting slacker fiscal behaviour, but subsequent events show that these perceptions were over-optimistic. This is an important point to bear in mind in view of the fact that the failure of attempts at pluri-annual budgetary planning (to say nothing of political programmes) is due mainly to over-optimism about medium-term growth. It seems necessary to question this bias, using methods like those described above, in order to ensure a more consistent and transparent form of monetary and fiscal planning. The importance of this matter is beyond doubt.

V

Conclusions

Estimation of the potential GDP with the Hodrick-Prescott method provides an elementary and immediate measure of macroeconomic fluctuations. According to the results obtained, the GDP gap (as a percentage of the potential GDP) varied between -11% and 17% in the Latin American countries in the 1980-1999 period. In the European Union, in contrast, the same indicator measured by the same means did not exceed 4% of the trend GDP. Such marked volatility of the level of activity has adverse consequences for the public deficit, and these are even greater when tax revenue represents a considerable proportion of public income. It is essential to identify a "sustainable" medium-term path and to formulate fiscal policy as a function of permanent sources of income generated when the economy is on its trend path.

According to the calculations presented here, the cyclical component of the central government deficit amounts to a maximum of one point of GDP in Argentina, Brazil, Chile, Peru and Uruguay. Although this amount is less than the levels registered in the OECD countries (which may be explained both by the method used, which may introduce a downward bias in the results, and by the relatively lower importance of tax revenue in the GDP) it is nevertheless by no means negligible in absolute terms. The elasticity of the public balance to changes in the level of activity is estimated to be around 0.2 (for every percentage point of the GDP gap the public balance varies by 0.2 points of GDP). The average value calculated for the European Community is 0.5. The magnitude of the automatic fiscal stabilizers and the uncertainty of the macroeconomic environment therefore warrant the

adoption of prudent criteria regarding the management of the public finances, not so much in terms of precise annual deficit targets but rather in terms of simple and transparent rules which ensure their medium-term stability.

In this respect, the rules on fiscal policy should not be based on the observed deficit, but rather on its discretionary component. The most important criterion seems to be to seek a balanced budget in normal conditions, which means planning expenditure and income in the light of a medium-term view of public finance management, thus avoiding constant variations in its formulation and execution. In economies as volatile as those of Latin America, the public sector cannot become a sounding board for short-term fluctuations. Full operation of the automatic fiscal stabilizers in Latin America would help to smooth out cyclical fluctuations, thus increasing long-term growth, improving global macroeconomic performance, and preventing the generation of harmful disturbances.

Imposing deterministic rules in a stochastic world can only bring in unnecessary rigidities; what is needed instead is to construct a set of institutions which ensure the application of counter-cyclical rules in normal times, while at the same time maintaining the capacity to respond to unforeseen situations. Economic policy management must be increasingly cautionary and prudential, with a form of management which is flexible but subject to socially concerted rules and clear accountability mechanisms, so as to put into practice the principles of transparency, stability and responsibility.

(Original: Spanish)

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Financial openness: *the experience of* Argentina, Brazil and Mexico

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This article seeks to analyse the effects of globalization on the financial systems of Argentina, Brazil and Mexico, which were the countries that received most of the foreign investment in the region in the 1990s. This capital was mostly made up of portfolio flows and investments in shares traded on the local financial systems. The movement was not homogeneous in all the countries, because of their different degrees of openness and differences in macroeconomic policies. In the case of the portfolio investments, the effects of the openness were concentrated in different segments and they therefore had different impacts on the financial systems in question. The recent experience of these countries shows that there is still some room for national economic policies to take action in the context of financial globalization, even though their capacity to reduce the perverse effects of financial flows is limited. Foreign firms are observed to be assuming growing importance in the countries studied, as a function of the degree of openness of the local financial systems. This tendency is due to the liberalization measures adopted in order to make possible capitalization of the banking systems and competition among banks to find new sources of profits and strengthen their position in globalized markets. Although the predominance of foreign companies has given a more solid capital base to the national banking systems, it could have an adverse macroeconomic impact, especially in Mexico and Brazil, which still maintain relatively independent monetary policies.

I

Introduction

This article seeks to analyse the effects of globalization on the financial systems of Argentina, Brazil and Mexico, which were the countries that received most of the foreign capital invested in Latin America since the beginning of the 1990s. In the context of the return of voluntary capital flows to the region, there has been an intensification of foreign investment in the local financial markets. This consists mostly of portfolio flows: that is to say, purchases of movable assets by non-resident investors, and foreign direct investment (FDI), through the acquisition of shares on local financial markets.

For the purposes of the present article, financial globalization is defined as a process involving elimination of the segmentation of the different local financial markets, interpenetration of the local monetary and financial markets and their integration with world markets (Chesnais, 1994). The effects of this process on the

local financial systems are not the same in each case, since they depend on the degree of financial openness and the way capital flows are treated by the economies. The greater the degree of financial openness –which is related with the capacity of residents to acquire securities and assume liabilities in foreign currency and the access of non-residents to the different segments of the local financial markets (Akyüz, 1992)– and the more receptive local policies are to the entry of external resources, the greater will be the influence of these flows on the respective financial systems.

The characteristics of capital flows from abroad and their effects on the financial markets of Argentina, Brazil and Mexico are studied in section II below, the expansion of foreign direct investment in local financial systems is dealt with in section III, and finally section IV presents the conclusions of this study.

II

External capital flows

This section describes the general characteristics of the recent process of financial openness in Argentina, Brazil and Mexico, with special attention to the regulatory framework which imposes discipline on the one hand on the investments made by non-residents and on the other on the monetary and financial transactions in foreign currency (or denominated in foreign currency) on local financial markets. The regulatory framework influences the composition of foreign portfolio investments –investments in public or private shares or fixed-income securities, foreign currency deposits in local banks,

or transactions in investment funds– and hence their different effects on the various segments of national financial markets.

1. The regulatory framework

The recent process of greater financial openness of the Latin American economies fits into a more general process of change in the international financial market and forms an integral part of the stabilization and reform programmes implemented as from the second half of the 1980s. However, the degrees of financial openness of the three countries studied here differ considerably from each other. In Argentina, the financial openness was complete. Mexico is in an intermediate position, while in Brazil there are still some restrictions on convertibility in the capital account, especially in respect of transactions in foreign currency within the national territory.

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In the 1990s, the financial openness of the Argentine economy was one of the main pillars of the monetary stabilization programme applied by the Menem administration. The Convertibility Plan provided for a fixed exchange rate regime with currency convertibility: that is to say, a currency board regime (Ferrari, 1998). In this context, the strategy adopted in order to eliminate hyperinflation and reverse the demonetization process was based on the designation of the U.S. dollar as legal tender.¹ This strategy involved total freedom of capital movements between the country and the exterior, as in this type of system the monetary base is determined by the variation in the international reserves, that is to say, the inflow of liquid external resources.

Various institutional reforms made possible and stimulated the development of the dollarized segment of the Argentine economy and its financial integration with the exterior. In 1989, it was decreed that financial institutions must return deposits in the same currency in which they were originally made, and the Central Bank was denied access to those resources. In 1991, total liberalization of the foreign exchange market was achieved and the Convertibility Act was adopted (Fanelli and Machinea, 1997). In addition to establishing a fixed exchange rate parity and the convertibility of the peso with respect to the dollar, this Act authorized the denomination of contracts in any foreign currency. Total convertibility of the capital account was achieved after deregulating the capital market in 1991 –which included the elimination of the tax on stock exchange transactions and the authorization for companies and banks to issue debentures and commercial paper negotiable in foreign currency– and adopting the Fiscal Amnesty Act in 1992, which permitted the tax-free repatriation of resources held abroad by Argentine citizens (Blejer and Rozenwurcel, 1997). In 1992, with the adoption of the new Articles of Incorporation of the Central Bank, the monetary reform process was completed by establishing the independence of the Central Bank of the Argentine Republic (CBAR) and sharply restricting its capacity to provide finance for the government and to act as lender of last resort (Ferrari, 1998).

In Mexico, the recent financial openness process included the liberalization of sales of securities by non-residents and sales of public and monetary securities on the stock markets and fitted into the broader context of the reform of the national financial system begun in the late 1980s (Armella, 1993; Skiles, 1991).

The Stock Exchange Act passed in December 1989 expanded the possibilities of access to the securities market by foreign investors through the creation of a new form of investment, the “Fondo Neutro” (“Neutral Fund”), which permitted these investors to acquire Series A shares.² Through this fund, foreign investors can acquire ordinary share certificates (CPOS), which cover the yields on the shares but not the equity rights. Up to that time, there had only been two types of foreign investment in the Mexican stock market: country funds –portfolios of shares in the most representative Mexican companies quoted on external financial markets– and freely subscribable shares (Series B shares). These shares, which were the traditional form of foreign investment in the Mexican stock market, continued to predominate even after the establishment of the Neutral Fund (Caro Razú, 1994).

The central element in the liberalization of the Mexican capital account in the 1990s was the opening up of the public securities market. The prohibition of the purchase of such securities by non-resident investors, which had been in force since 1980, was terminated in 1990 (Palomino, 1997 and Griffith-Jones, 1996). Furthermore, in December 1991, as part of the deregulation of the monetary market, transactions of Treasury Certificates (Cetes) between financial intermediaries and foreign investors were authorized (Caro Razú, 1994). These certificates are the main security traded on that market. The sale of private fixed-income securities was also liberalized.

There were two other measures which helped to establish closer links between foreign capital and the domestic financial market. One was the establishment of a simple and anonymous mechanism for repatriating resources invested abroad, subject to a flat rate tax of 1%. The other was the abolition in No-

¹ In Argentina, there was already progressive dollarization of monetary and financial relations in the 1980s, representing a response by the agents to chronic inflation and, in a second stage, hyperinflation (Machinea, 1996).

² In Mexico, there are several different types of shares: Series A shares guarantee full control of the capital invested, while those of the other series (Series B, C and L) only offer dividends on the shares.

vember 1991 of the dual exchange rate system which had been in effect since 1982. As in Argentina, the measure to provide an incentive for the repatriation of capital was of fundamental importance, in view of the magnitude of the capital flight which had taken place in the 1980s (Gurría, 1997).

The process of liberalization of the Mexican capital account was accompanied by the partial liberalization of transactions in foreign currency. From 1986 to 1991, deposits in foreign currency were only permitted for companies located near the United States border. In 1991, however, such deposits were authorized for natural persons residing in those localities and for Mexican legal persons in general. The conditions of access of non-residents to such deposits were eased somewhat in 1993, but continued to be restricted. Only official representatives of foreign governments, international organizations and foreign natural persons working for such organizations can open foreign currency deposits in Mexico. Because of these restrictions, such deposits account for only a small amount of resources and are mainly used in operations connected with foreign trade (Banxico, 1997 and 1998). As part of the domestic financial liberalization process, however, authorization was given for the issue of foreign currency-denominated securities such as the Tesobonos (very short-term 1 to 3 month Treasury bonds indexed in dollars) and bank certificates of deposit denominated in dollars (Armella, 1993).

In Brazil, foreign portfolio investments in the domestic financial market were significantly liberalized with the financial openness process of the 1990s. However, this liberalization was less pronounced than in Argentina and Mexico and affected the different markets—the money, fixed-income and stock markets—in differing ways. In the Brazilian banking system, deposits and loans in foreign currency are still prohibited for both residents and non-residents. One of the main conditions which made the application of this measure possible was the creation of indexed currency units in the 1980s (financial operations with a liquidity of one day), which, by replacing the national currency in its functions as a value reserve and unit of account, were able to prevent the dollarization of monetary and financial relations which took place, for example, in Argentina. Only a few transactions denominated in foreign currency are permitted, such as public securities indexed on the exchange rate and loans with ex-

change rate correction. The relative weight of these loans in the Brazilian financial system is not yet significant, however (Prates, 1997).

Various different mechanisms were established for foreign portfolio investment, differing both in the type of instrument used—direct entry, or entry through investment funds—and in the segment of the foreign exchange market through which they are made. Up to January 1998, the official exchange market consisted of two segments: the commercial exchange market, for trade and financial transactions of strategic importance for the economy (trade balance, factor services, external debt, foreign direct investment, and the main forms of foreign portfolio investment), and the floating exchange market, on which all other operations, such as unilateral transfers, tourism, etc., were carried out (Souza, 1993).

With regard to the commercial exchange market, in May 1991 foreign institutional investors³ were given direct and unrestricted access to the domestic stock market. Access by non-resident natural persons continues to be prohibited, however. The other investment alternatives are limited to specialized investment funds, which are subject to rules regarding placement and taxation at the time when funds are brought into the country and on capital gains, although these restrictions do not apply to investments in shares. Among these specialized funds,⁴ the most important is the Foreign Capital Fixed-Income Fund, whose resources must be invested in fixed-income securities, with a minimum of 40% being invested in public securities.

Foreign investors also have access to the Brazilian financial market through non-resident accounts on the floating exchange market. These accounts, which are in local currency, are not subject to restrictions as regards the use to be made of the resources, and are the main means of entry of “hot money”. As these flows are attracted by the spread between domestic and foreign interest rates, this form of investment was only profitable when this spread was substantial, because apart from the greater exchange risk involved—since they had to be effected on the

³ Brazilian legislation defines foreign institutional investors in quite broad terms, since in addition to pension funds and insurance companies they are considered to include foreign financial establishments and foreign-based investment funds.

⁴ The other funds are the privatization funds (for foreign capital), the investment funds in emerging enterprises, and the real estate investment funds.

TABLE 1

Argentina: Monetary aggregates of the economy, 1990-1997
(Percentages)

	1990	1991	1992	1993	1994	1995	1996	1997
M1 as % of GDP	2.1	4.3	5.2	6.0	6.1	6.7	7.7	8.6
M2 as % of GDP	3.8	7.4	9.5	11.8	11.9	11.1	13.0	11.1
M2 ^a as % of GDP	5.0	11.1	14.4	19.0	20.0	19.5	23.1	...
Deposits (US\$/total)	28.0	45.0	45.0	47.0	51.0	54.0	53.9	53.8
Time deposits (US\$/total)	30.0	54.0	54.0	58.0	65.3	71.9	72.3	...

Source: Data of the Central Bank of the Argentine Republic, in Fanelli and Machinea (1997), Carta Económica in Meyer (1997a) and Carta Económica in Ferrari (1998).

^a Includes deposits in dollars.

floating market— they were subject to higher rates of tax. Other than having to pay a higher rate of the tax on financial transactions, these operations received the same fiscal treatment as in the case of residents and were even subject to the provisional withholding tax on financial movements.

Through these mechanisms, the prevailing regulatory framework sought to select the capital flows effected on the commercial exchange market by establishing specific forms of application for variable-income and fixed-income investments. At the same time, an instrument was established for the floating exchange market with the aim of absorbing the most highly speculative external resources.⁵

2. The impact of foreign portfolio investments on Latin American financial markets

The impact of foreign portfolio investments on Latin American financial markets varies according to the different degrees of financial openness, the specific characteristics of each financial system, and the different options for the macroeconomic management of these flows. A fundamental aspect is that of the forms these investments take in domestic financial markets which have been liberalized. Portfolio investments involve considerable financial risks for the peripheral countries, especially in terms of possible exchange or banking crises. These risks depend both

on the term of the investments and on their characteristics: fixed-income or equity investments and short, medium or long-term flows (Basle Committee on Banking Supervision, 1995).

In Argentina, the Central Bank does not maintain detailed records of portfolio flows to the domestic financial market, but in general portfolio investments correspond to the unspecified capital movements registered in the "other movements" item of the balance of payments (Fanelli and Machinea, 1997).

The demand for financial assets and the degree of monetization of the Argentine economy began to recover in 1991, after the adoption of the Convertibility Plan, when capital flows changed direction (table 1). Both residents and non-residents used deposits in dollars to bring resources into the country. In this way, they protected themselves against the risk of devaluation and took advantage of the prevailing high domestic interest rates. The remainder of the capital flows went to the local stock exchanges (Fanelli and Machinea, 1997).

The inflow of capital played a fundamental role in the remonetization process and the recovery of the level of financial intermediation. The stabilization process and the adoption of currency convertibility were not reflected in any substantial recovery in the demand for national currency, however: on the contrary, they increased the degree of dollarization, as foreign-currency deposits came to predominate (Machinea, 1996).

The expansion of the dollarized segment was not accompanied by a corresponding increase in the term of deposits, which continued to be concentrated on a 30-day term. Because of the larger amount of foreign-currency finance, loans in dollars predominated. The relative share of such loans amounted to 58% of

⁵ In February 2000 the Brazilian Government decided to do away with the differential treatment for variable-income and fixed-income investments and authorized portfolio investments by physical persons in the Brazilian stock market. These changes, which came into force on 31 March 2000, increased the financial openness of the Brazilian economy and thus reduced the differences in terms of openness with the other countries analysed here.

TABLE 2

Mexico: Foreign portfolio investments in the Mexican financial market, 1991-1997
(Millions of dollars)

Year	Stocks					Government securities						
	ADR markets		Mexican stock market ^a		Total	Cetes		Tesobones		Other		Total
	Total amount	% total	Total amount	% total		Total amount	% total	Total amount	% total	Total amount	% total	
1991	13.7	73.9	4.9	26.1	18.6	3.0	54.0	0.3	4.7	2.2	41.3	5.5
1992	21.2	73.8	7.5	26.2	28.7	9.2	64.3	0.2	1.4	4.8	34.3	14.2
1993	34.0	62.2	20.6	37.8	54.6	15.4	70.2	1.3	5.9	5.2	23.9	21.9
1994	21.2	61.6	13.2	38.4	34.4	2.5	12.3	17.4	85.0	0.6	2.7	20.5
1995	15.2	62.1	9.3	37.9	24.5	2.8	82.0	0.2	5.6	0.4	12.4	3.4
1996	15.1	48.8	15.9	51.2	31.0	3.0	89.2	0.0	0.0	0.4	10.8	3.4
1997	23.1	47.2	25.7	52.5	48.8	3.0	90.3	0.0	0.0	0.3	90.7	3.3

Source: BANXICO, 1998.

^a Includes freely tradeable shares, "Neutral Fund" and country funds.

the total in 1994, compared with 40% in 1991 (Ferrari, 1998). These resources went mainly to production activities for the domestic market and finance for the purchase of consumer durables (Blejer and Rozenwurcel, 1997). Thus, the vulnerability of the Argentine financial system to the reversal of capital flows, which was inherent in the convertibility system, was further heightened by the liquidity of deposits in dollars (and in pesos) and the concentration of loans in the non-tradeable sectors, which increased the exposure of the banks' portfolios to exchange rate devaluation. The absence of a lender of last resort further accentuated this vulnerability, which became very evident with the Mexican crisis in December 1994. The outflow of capital due to the "tequila effect" was reflected in a serious banking crisis in the first half of 1995 and a profound economic recession.

It may be noted that the macroeconomic management applied under the domestic convertibility system presupposes a significant degree of receptiveness to capital flows. Under this system, the inflow of capital does not affect exchange and monetary policies –and is not therefore reflected in an increase in the public debt– but it is reflected in an increase in dollar deposits in the banks, which stimulates domestic demand and economic activity.

In Mexico, foreign portfolio investments represented over 60% of the capital flows received by the country between 1990 and 1994. These flows went in particular to the purchase of shares and Mexican government paper (table 2). Deposits in the banking

system, such as time deposits and bank certificates denominated in foreign currency, were not very significant. The segment of the Mexican financial market most affected by the financial openness process was the public securities market. In the case of the stock market, the impact of foreign portfolio investments was less marked because, up to 1995, most of the stocks were acquired through the use of American Depositary Receipts (ADRs). There was thus a transfer of liquidity to the United States securities exchanges, especially the New York Stock Exchange. In Mexico and Argentina, the flight from the local securities exchanges was heightened by the use of ADR programmes in the privatization process. The aim of these programmes was to reduce the possibility of saturation of the local market because of the large volume of the stocks traded compared with the size of those exchanges (ECLAC, 1995).

The large volume of foreign investments in public securities, until the outbreak of the Mexican crisis at the end of 1994, was the main special feature of Mexico in comparison with the other countries studied. Between 1990 and 1994, these operations accounted for 55% of total foreign portfolio investments. Between 1991 and 1993, non-residents absorbed the greater part of new issues of public securities, especially short-term ones, and their share of total Mexican public debt rose from 8% at the end of 1990 to 57% at the end of 1993 (Griffith-Jones, 1996).

In 1994 there was a significant change in the composition of the public debt in the hands of for-

eign investors. Treasury Certificates (Cetes), which are denominated in pesos, systematically took the place of Tesobonos, which were very short-term securities indexed in dollars (table 2). After February of that year, because of the rise in United States interest rates and the exchange risk associated with the upward trend of the current account deficit, the premium demanded by foreign investors for maintaining their holdings of Cetes increased considerably. In order to avoid an excessive increase in the cost of rolling over the public debt and an outflow of capital, the government began to offer Tesobonos to non-resident investors. As a result, by mid-1994 those investors held 80% of the total amount of such bonds outside the banking system (Goldestein and Turner, 1996).

The experience of Mexico shows the negative effects that can result from opening up the public debt securities market to foreign investors, especially when those securities are short-term and denominated in foreign currency. The Tesobonos market was one of the main focal points of the 1994 exchange crisis.⁶ The volume of those securities held by non-residents, which exceeded the size of the international reserves, increased the vulnerability of the balance of payments and the public accounts to a possible reorientation of capital flows. In view of the growing mistrust about the Mexican government's capacity to meet its liabilities in respect of those securities, foreign investors proceeded to sell off their holdings. As the reserves were only small compared with the magnitude of the capital flight, the Central Bank was unable to contain the exchange crisis and had to opt for a floating exchange rate. Furthermore, the public sector was faced with the need to refinance a large volume of short-term debts in dollars, whose local-currency value had risen because of the currency devaluation.

It may be noted that much of the increase in the public debt was associated with the monetary policy of partial sterilization of the inflow of external resources. By avoiding a drop in domestic interest rates, this policy encouraged capital inflows, but as the pub-

lic debt was acquired by non-residents the policy of sterilization did not do anything to reduce the vulnerability of the economy and the financial system to capital flows. On the contrary, this strategy heightened the external fragility of the Mexican economy. Apart from the sterilization policy, the more flexible exchange policy adopted (including the introduction of exchange-rate bands in 1991) and the fiscal surpluses achieved helped to partly offset the monetary impact of the external resources (Gurría, 1997).

In Brazil, almost all the foreign portfolio investors operated on the São Paulo stock exchange (Bovespa), the most important of the country. The amounts of external resources procured through investment funds were not significant. Only the Foreign Capital Fixed-Income Fund (FRFCE) attracted a fairly substantial amount of resources at the times of biggest interest rate spreads, mainly in public debt securities indexed on the exchange rate (similar to the Mexican Tesobonos). Investments made through non-resident accounts also went mainly to these securities, although the total volume in the hands of non-residents continues to be small.

As a result, the effects of the financial openness were concentrated in the secondary securities market. Unlike what happened in Mexico, up to 1997 the number of ADR programmes of Brazilian companies was small both in absolute terms and in comparison with the other Latin American countries, and the market value of the shares traded on the ADR market was equivalent to only 6.5% of the capital value of Bovespa's operations in December 1997 (Freitas and Prates, 1999). This is explained by the size of the Brazilian market, which has a higher level of capitalization and hence greater liquidity than the Mexican market. Moreover, in Brazil the privatization process has not so far involved the issue of ADRs. The share of foreign investors in the total amount traded on Bovespa has increased significantly in recent years, from 6.5% in 1991 to 29.4% in 1995. Along with the growth of this share there has also been a continual increase in the volumes traded and the capital value of the market (table 3).⁷

⁶ The other focal point was the banking system, because the banks held large amounts of short-term liabilities in foreign currency and part of them were guaranteed by Tesobonos. With regard to the Mexican banking crisis, see Griffith-Jones (1996) and Folkerts-Landau, Mathieson and Schinasi (1997).

⁷ It may be noted that the increase of over 100% between 1996 and 1997 in the volume traded was due to the privatization of Vale do Rio Doce and several State-owned electric power companies. These movements were also stimulated by the progress in the privatization of the Telebras and Eletrobras systems.

TABLE 3

Brazil: Participation by foreign investors in the São Paulo stock exchange, 1991-1997

Year	Foreign investment ^a	Total amount traded ^b	Capital turnover of the market ^b	Main stock traded ^c
1991	6.0	28.4	43 615.1	41.3
1993	16.0	96.4	99 430.1	50.2
1994	21.4	303.6	189 058.2	40.1
1995	29.4	233.3	147 560.0	49.8
1996	28.6	356.0	216 927.0	61.2
1997	25.9	786.7	255 409.0	55.86

Source: BOVESPA, *Revista Mensual*, various issues.

^a Foreign participation as a percentage of the total volume traded.

^b Millions of dollars.

^c As a percentage of the total volume traded.

In contrast, however, the financial openness did not help to reduce the degree of concentration of the secondary market or to boost the primary securities market. Purchases by foreign investors were concentrated in the stock of State enterprises in the process of privatization (especially Telebras-Brazilian Telecommunications), because of the prospect of an increase in their value once they had been privatized. Because of this, the market value and liquidity of shares in private companies continued to be low, thus discouraging demand by investors and new stock issues. The low volume of primary issues meant that the shares of those companies accounted for a smaller relative share of the secondary market, thus increasing the concentration of transactions in more liquid securities (Prates, 1999).

Although portfolio investments in shares are less volatile than fixed-income investments, because of the greater risk of capital loss, these investments also involve financial risks for the peripheral countries. Because of the large volume of capital flows compared with the size of the stock markets, the rearrangement of their portfolios by foreign investors has a strong impact on share prices (Akyüz, 1992). The effects of these movements on the Brazilian stock market were clearly visible during the Mexican and Asian crises. On those two occasions—in the first quarter of 1996 and the last quarter of 1997—stock prices fell sharply because of the sale of their holdings by foreign investors to cover their losses on other emerging markets or to increase their provisions for covering possible withdrawals by their clients.

III

The growth of foreign direct investments in national financial systems

During the 1990s the financial markets of the Latin American countries also attracted foreign direct investment in the form of equity participation in local financial intermediation companies or the installation of new branches or subsidiaries totally controlled by

foreign financial institutions. On the one hand, this tendency was fostered by the new competitive strategies of financial institutions in the industrialized countries, marked by the elimination of barriers between the activities of banks and non-bank financial

institutions and the concentration and centralization of capital in national markets through mergers and acquisitions, while the process was also facilitated by the abolition or easing of restrictions in a number of countries and the establishment of subsidiaries or branches of foreign institutions in local markets, the participation of non-residents in the equity of local institutions, and the activities of foreign financial intermediaries in local markets. These measures to liberalize the treatment accorded to foreign financial institutions were adopted both by the industrialized and by the peripheral countries (Freitas, 1999).

The increase in competition in the local markets of the central countries prompted banks and other financial intermediaries to seek new areas for making profits. In their efforts to strengthen their global positions, financial institutions opted for the geographical diversification of their activities through the establishment of branches or subsidiaries in foreign countries. The main difference between this process and the internationalization of the 1960s and 1970s is that the strategies of support for transnational enterprises and the supply of external finance which prevailed at that time gave way to a strategy of diversification of activities in the local markets of the host countries. This process calls for denser networks and greater integration of the foreign institutions into the local banking system.

Apart from the need to diversify outside their own saturated local markets, the recent entry of important financial groups into the region has also been stimulated by the stability of the Latin American economies, the prospect of numerous profitable business opportunities, and the existence in most cases of relatively weaker local competitors. The Spanish-speaking countries were the first targets for direct investments by these groups, but in the second half of the 1980s it was Brazil's turn. Indeed, the Brazilian market came to be the most highly prized in the region, as it offered the possibility of big profits for the foreign banks that set up operations there.

In this section, we will analyse the recent expansion of banking institutions in Argentina, Brazil and Mexico. We will begin by looking at the changes made in the legal and regulatory treatment given to foreign capital, after which we will analyse the expansion strategies adopted by foreign banks in those three countries and the results of their activities.

1. Changes in the legal treatment given to foreign capital

The three countries analysed here have different features as regards the legal treatment given to foreign institutions. Whereas the regulatory environment in Argentina was more favourable for those institutions, in Mexico and Brazil the prevailing conditions for the establishment of branches by non-resident institutions and for participation in the equity of local institutions were more restrictive. This accounts for the different degrees of openness and liberalization.

In Argentina, the openness of the local financial system was promoted as part of the 1977 financial reforms, when all restrictions on the entry of new institutions and the expansion of bank networks were abolished, both for local and foreign institutions (Feldman and Sommer, 1984). In practice, the Argentine legislation adopted the principle of according foreign banks the same treatment as local ones, so that they were subject to the same rules, or rules that were no less favourable. This legislation also expanded the range of permissible activities for all banks.

The non-discriminatory treatment given to foreign capital made possible the recent denationalization of the Argentine financial system. As from 1997, foreign institutions –which occupied only modest positions in the local market in the period of high inflation– embarked on a series of total or partial purchases of local banks. At present, with the exception of the two big public banks –the Banco de la Nación and the Banco de la Provincia de Buenos Aires– and one private bank (Banco Galicia y Buenos Aires), all the main Argentine banks are controlled by non-residents.

The three biggest private banks controlled by non-residents have continually increased their market shares, with the introduction of new products (Folkerts-Landau, Mathieson and Schinasi, 1997, p. 161). The concentration of the Argentine banking system is also reflected in the total number of institutions, which went down from 205 in December 1994 to 138 in December 1997.

In Mexico, the entry of foreign banks was prohibited until the 1990s. These institutions were only allowed to be present as representation offices, with a very limited field of activity, since they could not carry out any financial intermediation operations

whatever. Furthermore, from the nationalization of the banking system in 1981 up to its privatization in the early 1990s, the establishment of new institutions was prohibited even for residents.

In July 1990, with the entry into force of a new law on credit institutions, the conditions of access of foreign financial institutions to the local financial system began to be eased. Under this law, the Ministry of Finance and Public Credit, which is responsible for the regulation of financial institutions, was empowered to authorize the establishment of agencies of foreign banks in the country. These branches could only operate with non-residents, however (Ferreira and others, 1998). At the same time, minority foreign participation in the equity of brokerage houses was also authorized.

In April 1994, under the terms of the North American Free Trade Agreement, rules were adopted on the establishment of Mexican branches of foreign financial institutions, authorizing the direct opening of branches of United States and Canadian banks and stockbroking firms and the formation of ten foreign financial groups, six of which included a bank. In addition, thirteen branches of foreign insurance companies were authorized to operate in the country (Palomino, 1997).

A further easing of the restrictions on foreign banks in Mexico took place in the context of the serious crisis in the banking system in 1994. With the aim of shoring up the capital of institutions damaged by the crisis, the legislation on the structure of the equity of banks and holding companies of financial groups was reformulated in February 1995 to permit the participation of foreign legal persons (Banxico, 1996). Non-residents were authorized to acquire series B and L shares up to an individual limit of 20% of the equity of Mexican institutions. This limit could be increased, however, if a branch of a foreign bank gained control of a local bank by purchasing all the series A shares. In order to prevent the biggest banks from being acquired by foreign institutions, the Ministry of Finance and Public Credit laid down that no individual foreign bank could own more than 6% of the total assets of the domestic banking system (Meyer, 1997b).

It should be noted that the Mexican Government authorized foreign institutions to participate in the privatization of the banking system. Their participation was limited to 30% of the total capital, however, with an individual ceiling of 5% for each investor. At

the end of 1998 the Mexican Congress did away with this restriction, thus making possible majority foreign control of national commercial banks, including the three largest: Banamex, Bancomer and Serfin (Taylor, 1999).

In Brazil, except for the period from 1946 to 1964, when there was complete freedom of access of foreign institutions to the local financial system, there have always been restrictive rules, either on the entry of foreign banks or on the conditions under which they can operate on the local market. From the 1965 financial reforms up to 1995, foreign direct investment in the banking system and the range of activities foreign banks were allowed to engage in depended on the principle of reciprocity. Under this approach, the Brazilian Government only permitted the entry of banks from countries which likewise permitted the access of Brazilian banks to their financial systems. Representation offices could be freely established throughout this period, however.

After the 1988 Constitution came into force, the access of foreign capital to the financial system was virtually prohibited, since it depended on the formulation by Congress of a regulatory framework for which the corresponding regulations have still not been adopted. However, article 52 of the Transitory Constitutional Provisions did leave open the possibility of the entry of foreign institutions into the Brazilian market through authorizations resulting from international agreements involving the principle of reciprocity, as a counterpart for the establishment of branches of Brazilian banks abroad, or in circumstances considered by the government to involve the "national interest". Applications were to be examined on a case-by-case basis, subject to the final approval of the President of the Republic.

In August 1995, taking advantage of this prerogative, the government declared, in Exposition of Motives No. 311, that it was in the country's interest to permit the entry or expansion of foreign participation in the national financial system. This decision was taken in the light of the growing fragility of the national financial system, which had been affected by an abrupt contraction of liquidity due to the restrictive economic measures adopted to cope with the impact of the Mexican crisis. The opening up of the financial system also satisfied the desires of many foreign financial institutions

and represented a partial concession to the demands expressed in many international forums, such as the World Trade Organization, MERCOSUR and the Free Trade Area of the Americas.

The opening up of the capital market, the privatization and industrial restructuring processes, and the possible business opportunities associated with financing the renewal of the economic infrastructure were the main attractions for foreign direct investment in the Brazilian financial system. Various financial institutions showed great interest in operating in the country in order to take advantage of the big possibilities for business and profits that existed, especially in the investment banking sector. The growth potential of retail trade and bank accounts was also a big attraction for the foreign banks, both those that were only now entering the market and those that were already established in the country. Whereas there is only one bank for every 4,500 persons in Brazil, in Germany there is one for every 2,000, and in Spain, one for every 1,100 persons (*The Economist*, 1998, p. 61).

The announcement of the government's decision to authorize foreign participation in the equity of local private institutions and in the privatization of the public banks, as well as to allow the establishment of new foreign subsidiaries, stimulated the interest of foreign institutions in entering the local financial market. As from August 1995, there was a considerable increase in the contacts between local banks and foreign institutions interested in associating with them, acquiring a majority share of their equity or even buying them outright.

This movement took on such proportions that the Central Bank began to demand that institutions requesting authorization to enter the market or expand their activities should pay a kind of "toll" as a contribution to the public resources used to put the financial system on a sound footing, except when the foreign institutions were acquiring banks that were insolvent or in serious financial difficulties (Freitas, 1999).

These measures to ease the conditions for the entry or functioning of foreign banks have been highly recommended to developing country governments by the representatives of multilateral agencies such as the International Monetary Fund or the World Bank. In the view of these official agencies, greater participation by foreign capital in local banking systems will help to strengthen the

ability of the latter to weather macroeconomic crises, as possible difficulties of the local subsidiaries of foreign banks will not automatically cause them to go bankrupt. In addition, it is expected that, through the introduction of "greater competition", foreign financial capital will solve the main shortcomings of local financial markets, such as their high spreads and costs compared with international levels, the high concentration of risks, and the existence of restricted markets.

2. The expansion strategies of foreign banks

In order to diversify their activities abroad, banks adopt various expansion strategies in keeping with the regulatory and legal framework of the host country. For new arrivals, the choice lies between opening a totally controlled local branch or subsidiary or acquiring equity participation in a local institution. Foreign banks which are already present in the country usually prefer either gradual growth through the establishment of a network of branches to expand their business base, or an aggressive policy of purchasing market shares by absorbing their competitors. The form of expansion adopted is closely related to the range of institutions existing in the different markets. This typology can be used to analyse the recent expansion of foreign banks' activities in Latin America.

As may be seen from table 4, in Mexico foreign banks took advantage of the more flexible access conditions applied after the 1995 financial crisis to acquire shares in the equity of the local institutions placed under the control of the local supervisory body, the National Banking and Securities Commission, and/or financed by FOBAPROA, the bank deposit guarantee fund. In Brazil, some foreign institutions also opted to acquire equity control of local banks, while others preferred to set up branches or subsidiaries.

With regard to the expansion of banks already present in the region, an examination of recent trends shows that in Argentina the preferred method used by foreign institutions to strengthen their positions in the local market was the absorption or purchase of majority shares in local banks (table 5). In Brazil, the oldest-established banks in the country, such as Lloyds Bank and the ABN-Amro Bank, adopted different expansion strategies. In Mexico, the local subsidiary of Citibank –the only survivor of the

TABLE 4

Brazil and Mexico: Main participants in the banking internationalization process, 1995-1998

Host country	Institution	Country of origin	Manner of entry
Brazil	Hong Kong and Shanghai Banking Corporation (HSBC)	United Kingdom	Acquisition of the assets of the Banco Bamerindus (bankrupt)
	Groupe Crédit Suisse	Switzerland	Acquisition of the Banco Garantía
	Nations Bank	United States	Acquisition of 51% of the equity of the Banco Liberal
	United Bank of Switzerland	Switzerland	Establishment of a wholly-owned subsidiary
	Banco Bilbao Vizcaya (BBV)	Spain	Acquisition of the Banco Excel-Económico (bankrupt)
	Rabobank	Netherlands	Establishment of a branch
Mexico	Banco Bilbao Vizcaya (BBV)	Spain	Acquisition of 70% of the Probusa group
	Bank of Nova Scotia	Canada	Acquisition of 45% of the equity of the Banco Inverlat
	Bank of Montreal	Canada	Acquisition of 16% of Bancomer
	A.G. Alemania	Germany	Acquisition of control of the Banco Banoro and Bancrecer
	Banco Santander	Spain	Establishment of subsidiaries and acquisition of 51% of the equity of the Banco Mexicano
	Hong Kong and Shanghai Banking Corporation (HSBC)	United Kingdom	Acquisition of 20% of the equity of the Serfin group
	Banco Central	Spain	Acquisition of 10% of the equity of the Prima
	Hispano		International group

Source: Conger (1998); Freitas (1999); Warner (1995 and 1998); Del Villar and others (1997); Taylor (1997a and b); *The Banker* (1997a); Cypher (1996).

nationalization process of the 1980s—acquired the Confia bank in August 1997. This bank had been intervened by the Central Bank because of its irregular activities abroad (*The Banker*, 1997b, p. 46).

In the three countries analysed, the aggressive strategies adopted by Spanish banks, and also by new rivals such as the Hong Kong and Shanghai Banking Corporation (HSBC), forced the foreign banks which had already been established in the region for a long time to take defensive measures. Some of them opted to expand their networks of branches, as BankBoston did in Brazil and Argentina, while others—such as Bankers Trust in Argentina and Lloyds Bank, Chase Manhattan and ABN-Amro in Brazil—decided to buy local banks or shares in their equity.

The result of this recent internationalization process suggests that foreign institutions are likely to take on growing importance in the local financial markets of the countries analysed. The rate of expansion of the foreign banking presence varies considerably from one country to another, however. Between December 1994 and December 1998, foreign participation in the local financial systems increased more rapidly in Mexico than in Brazil and Argentina

(table 6). In Mexico, this expansion was very substantial: at the end of 1998, foreign banks possessed 40% of the market compared with only 1.2% in 1994. The advance of foreign banks was also considerable in Brazil, especially in 1997 and 1998. In Argentina, the latest figures available are for 1997, but it may be assumed that foreign participation has increased in 1998 because the process of acquisition of local banks has continued.

The different rates of internationalization reflect the heterogeneity of the regulatory frameworks existing in each country. As it is the most open, the Argentine banking system is most likely to register a further increase in foreign participation. In Mexico, some legal restrictions which limit the expansion possibilities of financial institutions are still in force, despite the new financial law approved by Congress at the end of 1998. Brazil is in an intermediate position, as the legal loophole opened by the government may be closed if Congress finally decides to adopt financial system legislation which restores the limitations previously in force under the pressure of influential local banking interests.

TABLE 5

Latin America: Examples of the recent expansion of foreign banks

Host country	Institution	Country of origin	Manner of expansion
Argentina	Hong Kong and Shanghai Banking Corporation (HSBC)	United Kingdom	Acquisition of 100% of the Banco Roberts
	BankBoston	United States	Expansion of network of branches
	Banco Santander	Spain	Acquisition of 51% of the equity of the Banco Río de la Plata
	Bank of Nova Scotia	Canada	Increase from 25% to 100% of participation in the equity of the Banco Quilmes
	Grupo Socimer	Switzerland	Acquisition of 30% of the equity of the Banco Patricios
	Bankers Trust	United States	Acquisition of 51% of the Banco Liniers Sudamericano
	Crédit Agricole Banco Bilbao Vizcaya (BBV)	France Spain	Acquisition of 1/3 of the equity of the Banco Bisel Merger of the Banco Francés del Río de la Plata, controlled by BBV, with the Banco de Crédito Argentino
Brazil	Citibank	United States	Expansion of network of branches
	BankBoston	United States	Expansion of network of branches
	Banco Santander	Spain	Acquisition of 51% of the equity of the Banco Geral do Comércio and of the Banco Noroeste
	Lloyds Bank	United Kingdom	Acquisition of the Banco Multiplic and its finance company
	ABN-Amro Bank	Netherlands	Acquisition of 40% of the equity of the Banco Real
	Chase Manhattan Banque Nationale de Paris (BNP)	United States France	Acquisition of the Banco Patrimônio Acquisition of the Banco FonteCindam
Mexico	Citibank	United States	Acquisition of the Banco Confia

Source: Conger (1998); Freitas (1999); Warner (1995 and 1998); Taylor (1997a and b); *The Banker* (1997a and b).

TABLE 6

Argentina, Brazil and Mexico: Evolution of foreign participation in the local financial systems

Country	Foreign-owned assets, as a percentage of the total assets of the banking system		
	December 1994	December 1997	December 1998
Argentina	21.7	45.0	...
Brazil	11.0	21.1	22.5
Mexico	1.2	19.9	40.0

Source: Goldenstein and Turner (1996); Palomino (1997); Folkerts-Landau, Mathieson and Schinasi (1997, p. 165); *The Economist* (1997); KPMG Peat Marwick (1998), and Conger (1999).

Differences in the institutional aspects of finances in these three countries also undoubtedly help to explain the greater or lesser success that foreign banks have had in gaining positions in the local markets. Thus, for example, Argentine and Mexican banks are smaller than those of Brazil. Of the ten biggest Latin American banks in December 1997, six were Brazilian, three were Argentine, and only one was Mexican (table 7). In addition to their extensive networks of branches, Brazilian banks also use sophisticated technologies for electronic transfers of funds and resource management. These technologies, which were developed in a period of high inflation, will help them to keep their clients and avoid the financial dis-intermediation suffered by Argentine and Mexican banks, while they also place them (especially in the case of the big banks) in a position to

TABLE 7

Situation of the ten largest Argentine, Brazilian and Mexican banks in December 1997

Institution	Country	Ownership	Capital (millions of dollars)	Ranking	
				Latin America ^a	World ^b
Banco do Brasil	Brazil	Public	5 562	1	63
Bradesco	Brazil	Private	5 481	2	65
Itaú	Brazil	Private	3 893	3	99
Unibanco	Brazil	Private	2 373	4	145
Banespa	Brazil	Public	2 350	5	147
Nación Argentina	Argentina	Public	2 002	6	166
Banamex	Mexico	Private	1 790	7	181
Bancomer	Mexico	Private	1 659	8	196
Banco Real	Brazil	Private	1 581	9	200
Provincia de Buenos Aires	Argentina	Public	1 223	10	238
<i>Compared with:</i>					
Hong Kong and Shanghai					
Banking Corporation (HSBC)	United Kingdom	Private	27 392	-	1
Citicorp	United States	Private	22 211	-	4
ABN-Amro	Netherlands	Private	15 864	-	8
Nations Bank	United States	Private	13 599	-	13
Santander	Spain	Private	7 952	-	40
Bank of Nova Scotia	Canada	Private	6 820	-	49
Banco Bilbao Vizcaya	Spain	Private	6 800	-	50

Source: *The Banker* (1998).

^a The 25 largest banks, according to their capital, excluding wholly-owned subsidiaries of foreign banks.

^b The 1,000 largest banks, according to their capital.

compete with the foreign banks operating in the country.

Compared with the other Latin American banks, the Brazilian banks also benefit from the fact that the national banking system has not gone through any profound, generalized crises in recent decades. Furthermore, the local banking institutions are not viewed with mistrust by the public: on the contrary, public banks attract more clients than the private institutions when the financial situation becomes more delicate.

The most vulnerable aspect of the Brazilian banks is their relatively small volume of capital compared with the foreign banks. This is also true of the Argentine and Mexican banks. Indeed, the HSBC alone has more capital than the ten biggest Latin American banks put together (table 7). In the countries where such actions are permitted, the local banks are extremely vulnerable to the threat of a hostile takeover by foreign institutions.

IV

Conclusions

As we have tried to show, the impact of foreign investments (portfolio and direct) on the Latin American financial markets varies according to the different degrees of financial openness, the specific institutional characteristics of each national financial system, and the different macroeconomic management options with regard to external capital flows.

In the three countries studied here, the profile of portfolio investments in the local financial markets was determined by the different financial openness policies, influenced (among other factors) by the monetary stabilization strategies adopted, which also determined the different degrees of freedom of macroeconomic management with regard to capital flows. In Argentina, the adoption of a stabilization plan based on a currency board system meant the total financial openness of the economy. In Mexico and Brazil, the anti-inflation policies followed did not call for the complete liberalization of the capital account and the adoption of currency convertibility. Furthermore, the exchange-rate and monetary system in force after stabilization (exchange-rate bands) allowed some leeway for the macroeconomic management of capital flows through expansion of the exchange-rate fluctuation band in order to discourage the entry of short-term flows and the sterilization of capital inflows through the issue of public securities.

The effects of the opening-up of local financial markets were concentrated in different segments: in the money market in Argentina, in the public securities market in Mexico, and in the secondary stock market in Brazil. For this reason, the impacts of foreign direct investment on the national financial systems and, ultimately, on the economy as a whole, differed both in terms of the moments of abundance and the changes in direction of those flows. The upsets caused by a capital flight due to the sudden withdrawal of non-residents' bank deposits (which are generally used to finance domestic credit operations) are, potentially, much more harmful than those associated with the massive sale of shares by foreign investors, because in Latin America there is little integration between the credit and stock markets (either through cross-participation or through the use of

such documents as loan collateral). Consequently, the repercussions of financial openness on the peripheral economies also depend on the structural characteristics of the national financial systems.

In spite of the common features of the economic policy strategies of the three countries analysed – stabilization plans with an exchange-rate anchor, financial and trade openness, privatization, etc. – the experience of Argentina, Mexico and Brazil in the 1990s shows that there is still some leeway for national policies in the context of the present financial globalization. Those policies can reduce the financial risks associated with foreign portfolio investment, as those risks are directly related with the nature of capital flows and their maturities.

With regard to the local financial systems, there is a trend towards the growing importance of foreign institutions in the financial markets of the three countries in question. This trend is due, above all, to the liberalization measures taken by the governments to bring capital into their weakened bank finance systems. This greater foreign participation is also due to the competitive strategies of the banks themselves, which are trying to find new sources of profits and to strengthen their positions in increasingly globalized markets.

Contrary to the claims of the multilateral organizations, which advocate opening up the financial systems of the developing countries to foreign institutions, there is no guarantee that the entry of new competitors will be reflected in lower credit rates and costs. The entry of new institutions and the increase in the foreign presence in the countries studied is basically motivated by the desire to make big profits. In this respect, even though they may have competitive advantages over the local banks it is hard to imagine the foreign institutions forgoing high incomes by reducing their rates and margins. Where this does happen, it is rather a question of short-term marketing strategies than of a lasting policy. Moreover, competition in terms of prices is only one of the various competitive strategies of a banking institution. The possible positive impact of greater foreign participation on the cost of banking services and the

financial conditions of the local economies, as well as on the quality of the banking services offered to the public, remains to be seen. It is an unknown quantity, and only time will tell.

There is, however, one aspect that is worth mentioning as a beneficial consequence of greater participation by foreign banks, namely, the increased financial solidity of the national banking systems. There can be no doubt that stronger institutions have a greater capacity to withstand macroeconomic shocks, thus reducing the possibility of systemic crises.

Nevertheless, the possibility of migration of resources to foreign banks in the event of capital flight, as a safety measure by the public in the face of the possible insolvency of a major domestic private bank, would undoubtedly have harmful effects on macroeconomic management in countries like Brazil and Mexico, which still enjoy relative monetary sovereignty because they have not adopted the currency board system. In a context marked by the predominance of foreign institutions, the monetary authorities would have the greatest difficulty in handling the

liquidity conditions of the system. The Brazilian authorities faced a situation of this type in 1995, when the rise in domestic interest rates in response to the adverse reactions to the Mexican crisis profoundly affected the local banking system. With the rise in interest rates and the increase in the number of bad debts, the banks became more selective, thus complicating the refinancing of non-financial debtors and of the banking institutions most dependent on inter-bank transactions. On that occasion, the preference of the private banks (both domestic and foreign) for liquidity cancelled out the Central Bank's efforts to reactivate the inter-bank market. Had it not been for the aid of the main public banks, which acted as lenders of last resort for the banks which were having difficulties, the financial fragility of the banking system could have got worse and set off a generalized crisis. This experience suggests that it is important for developing countries to have a mixed banking system in which well-managed public banks coexist with domestic and foreign private banks and aid in achieving the objectives of government policy.

(Original: Portuguese)

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The Spanish banks' *strategies in* Latin America

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After more than ten years of a broad-ranging and extensive process of financial liberalization and deregulation, the Latin American picture in the banking, insurance and pension fund markets has been significantly changed by the massive presence of globalized financial institutions. The major Spanish banks have been among the main actors in this respect and have become leading figures in most countries and business segments. From the Latin American standpoint, the entry of foreign banks, especially those of Spain, has helped to invigorate and modernize the financial systems of the region; has brought in new instruments and technologies; has increased competition, with direct effects on access to credit and its cost, and has given the local financial systems greater strength and stability. However, it has also given rise to some difficulties, such as greater concentration and only a very slow process of handing on to clients the benefits of the greater competition and efficiency achieved in the Latin American financial markets. This extensive presence of Spanish banks, together with the active expansion of Spanish non-financial companies in the main Latin American markets, has revealed the limitations of the local regulatory frameworks for coping with the growing globalization of international markets. Thus, decisions taken in Europe affect users in Latin America, causing reactions at various levels whose results will only become evident in the future.

I

Introduction

The profound changes undergone by the economies of the region –openness, liberalization and deregulation– have given rise to a new business environment in Latin America which provides easier access for foreign investors. In the 1990s, foreign direct investment (FDI) flows to Latin America and the Caribbean registered unprecedented growth rates, rising from US\$ 9.2 billion in 1990 to nearly US\$ 86 billion in 1999 (ECLAC, 2000). This means that over 65% of the present stock of FDI entered in the 1990s. In practice, then, foreign investments in the region have been almost completely renewed. This phenomenon has been marked by major changes in the origin, destination and strategies of foreign investors (ECLAC, 2000; Calderón and Vodusek, 1998:

- Although foreign investors' interest has continued to be centered on the biggest economies of the region, they have shown gradually increasing interest in the smaller countries.
- The generalized predominance of United States companies is beginning to be offset by the massive arrival of European companies, mainly from Spain, the United Kingdom, the Netherlands and France.
- Investments in manufacturing activities have been replaced by investments in services, especially telecommunications, retail trade, energy and finance. This has given rise to a massive inflow of companies which are setting up operations in Latin America for the first time.
- Foreign investors have mostly resorted to the purchase of existing assets to enter the region or expand their presence in it, first through the extensive privatization programmes and later through the acquisition of local private firms.

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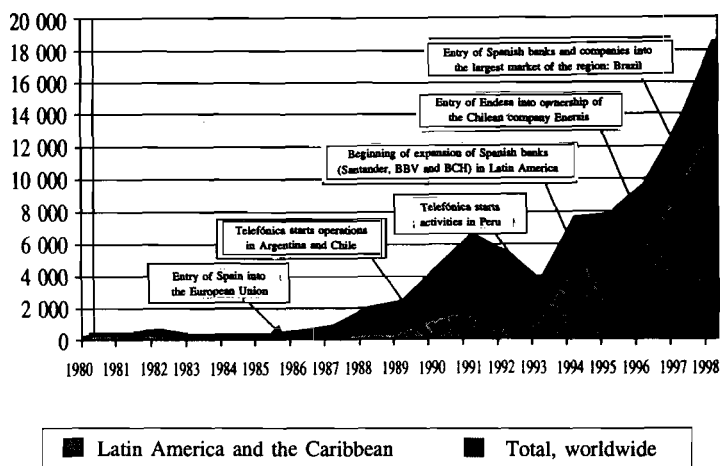
In this new setting, Spanish companies have become leading actors. After having been almost totally absent at the beginning of the 1990s, now, at the end of the decade, Spain has become the second largest investor in the region and the largest investor of European origin (Calderón, 1999a). In this period, the largest Spanish companies concentrated their expansion strategy on the services area of Latin America, through the acquisition of existing assets, in order to cope with the challenges posed by the creation of the Single Market and a common currency in Europe (figure 1).

Major Spanish investments in Latin America began in the early 1990s with the strong presence of Telefónica and Iberia in the privatization processes of the region; subsequently they were further strengthened with the entry of Endesa España and Repsol in the middle of the decade, and they took on really large dimensions with the acquisition strategy implemented by banking institutions from 1996 on (figure 1). In aggregate terms, the financial sector (mainly banks and insurance) has been the main direct Spanish investor abroad, only exceeded recently by big investments of the telecommunications and energy companies: the participation of Telefónica de España in the privatization of the Telebras system in mid-1998 and the assumption by Repsol and Endesa España of the control and management of the biggest private energy companies of Argentina and Chile (Yacimientos Petrolíferos Fiscales (YPF) and Enersis, respectively) early in 1999 (Calderón, 1999b).

The largest Spanish banks have invested nearly US\$ 10 billion in their Latin American expansion process. Thus, Banco Bilbao Vizcaya (BBV), Banco Santander and Banco Central Hispano (BCH) –the last two of which recently merged– saw a unique opportunity in the region to attain dimensions that would allow them to compete better in the demanding international financial markets and thus maintain their identity, diversify risks, and defend themselves against possible hostile takeover bids by competitors.

FIGURE 1

Spain: Evolution of direct investments abroad, 1980-1998
(Millions of dollars)



Source: ECLAC, Information Centre of the Business Strategies and Investments Unit of the Division of Production, Productivity and Management, on the basis of data from the Dirección General de Economía Internacional y Transacciones Exteriores (DGEITE) of the Ministry of the Economy and Finance of Spain.

II

The changes in the Spanish banking system

In the mid-1970s the Spanish authorities began a process of liberalization and deregulation of financial activities. From 1985 on, the process of change in the Spanish banking system speeded up with the incorporation of new technologies, products and consumer habits, the increase in dis-intermediation, and the entry of Spain into the European Union (EU). Subsequently, the changes in the structure and strategies of the financial institutions became still more radical with the formation of the Single European Market and the beginning of the process of economic and monetary union in preparation for the entry into use of the single currency, the Euro.

At the beginning of the 1980s, the Spanish banking sector was content to satisfy the existing demand for basic products in a context of limited competition. During the 1980s, however, the profound changes which took place brought the market to the verge of total saturation, there was a considerable in-

crease in competition, and the private banks were obliged to redefine their strategies to satisfy the demands and needs of their clients (persons, companies and institutions). Thus, the system changed from a product-oriented to a client-oriented banking system: a process which has been typical of the financial innovation phenomenon worldwide (Casilda, Lamothe and Monjas, 1997).

In this situation, the banks were mainly concerned with maintaining their levels of profitability, to which end they made significant cuts in their operating costs. They reduced the number of banking institutions (concentration increased through mergers), they made staff cuts, and they reduced the number of branches in their local networks. At the end of the 1980s, competition in the Spanish banking system began to become really marked, with consequent differences in the strategies adopted by the different institutions. This process was heightened when the

Banco Santander brought out a high-yield current account called "SuperCuenta":¹ an initiative which was quickly copied by the other banks.

The establishment of the Single European Market meant the elimination of barriers to the free circulation of capital among the member countries of the European Union, as well as freedom to establish and provide banking services. Thus, the financial sector in both Spain and the rest of the European Union began to develop new growth and concentration strategies in order to adapt to this new competitive environment. On 1 January 1993, with the entry into force of a set of directives drafted by the European Council on the free circulation of capital and the creation of Community-wide financial institutions through a single banking licence, formal European Union regulations came into effect for the credit institutions market. On 14 July 1995, by Royal Decree, the Spanish Government incorporated these Community regulations into the national financial legislation.

Important multilateral commitments have also been entered into with regard to financial services, and these have speeded up changes in the strategies of the main institutions and national markets, at both the regional and world level. In December 1997 the negotiations (also known as the Fifth Protocol) on financial services were completed in the World Trade Organization (WTO).

The banking market has begun to move from a form of competition based on geographical proximity and the provision of free services to another more generalized form marked by aggressive competition in price policies and the supply of products and services (Casilda, 1997). We thus see that the single currency situation has obliged banking institutions either to achieve the necessary economies of scale (size) or to offer competitive advantages in a particular segment of the market (specialization).

Since the end of the 1980s, the large banks have followed a growth strategy based on mergers and acquisitions, for two reasons: to strengthen their market presence (first at the national level and later internationally) and to increase their competitiveness. In

1988 the Banco de Bilbao and the Banco de Vizcaya merged to form the Banco Bilbao Vizcaya (BBV), and this was followed in 1991 by the fusion of the Banco Central with the Banco Hispano to form the Banco Central Hispano (BCH) and the establishment of the Spanish Banking Corporation (Argentaria);² in 1994 the Banco Santander took control of the Banco Español de Crédito (Banesto), and in 1998 the Banco Exterior de España (BEX), the Caja Postal and the Banco Hipotecario merged with Argentaria. At the beginning of 1999 the Banco Santander and the BCH merged to form one of the largest banking institutions in Europe, the Banco Santander Central Hispano (BSCH), and in October of the same year the BBV and Argentaria merged to form the second largest Spanish bank, the Banco Bilbao Vizcaya Argentaria (BBVA).

This process has brought the Spanish banking market to an increasingly high level of concentration which is now one of the highest in Europe. The market share of the five largest banks grew from 33% in 1987 to 50% in 1996. In the latter year, the corresponding levels of concentration were 41% in France, 35% in Italy, 28% in the United Kingdom and 25% in Germany (Casilda, Lamothe and Monjas, 1997). At the end of 1999, the two largest Spanish institutions (BSCH and BBVA) had 37% and 30% respectively of the credit and deposits market (*Expansión*, 1999a). Parallel with this process, as expected, there was an increase in both efficiency and competition (basically as a result of the ongoing decline in intermediation spreads), which furthered modernization, innovation and improved service to clients.

At the same time, this policy of mergers and acquisitions allowed the large banks to attain a suitable size for embarking on a strategy of internationalization. In the case of Spain, this process has been centered on Portugal, France, Italy, Morocco and especially Latin America. Likewise, and in parallel, there has been an increase in the signing of cooperation agreements between institutions of different Community member countries in order to defend themselves against the competition of the great banks which have been growing up as truly European-scale institutions. Thus, some of the biggest Spanish banks

¹ The SuperCuenta was the first current account to pay interest on the balance, and it allowed the Banco Santander to increase its market share by 50%. This product was followed by others, such as SuperDepósitos and SuperHipotecas, which forced the main Spanish banks to engage in a new round of competition, both in products and in market shares.

² Argentaria grouped together the entire public banking system. Its privatization was fully completed in 1998.

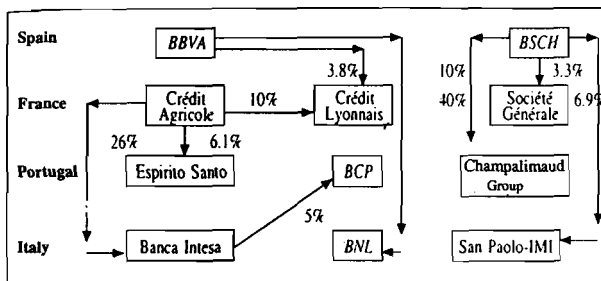
have sought to extend their presence to other markets through alliances and the purchase of minority shares in other European institutions.

In this respect, the BBVA acquired 10% of the Banca Nazionale del Lavoro (BNL), 3.8% of the French bank Crédit Lyonnais, and a securities company in Portugal (Midas); the Banco Santander bought nearly 5% of the Italian institution San Paolo-IMI and 10% of the Royal Bank of Scotland; the BCH had minor shares in Commerzbank (3%) and Société Générale (1.2%) and, until its merger with the Banco Santander, a strategic alliance with the Banco Comercial Português (BCP); and Argentaria had a strategic alliance with the Franco-Belgian group Dexia. Furthermore, at the end of 1999 the BSCH and the Portuguese group Champalimaud were negotiating a strategic alliance and the new Spanish institution increased its share in Société Générale to 3.3% and in San Paolo-IMI to 6.9% (figure 2). Early in 2000 there was speculation about a strategic alliance between the BBVA and the third largest Italian institution UniCredito Italiano. If this operation were to be completed successfully, it would form the biggest European trans-border alliance (*The Economist*, 1999; *Expansión*, 1999b).

In the increasingly competitive context resulting from both economic and financial globalization in general and the establishment of the Single Market and single currency in Europe, however, it is extremely likely that the pressures on the Spanish banking system will increase. Indeed, there has been an increase in the participation of foreign investors in the main Spanish banking institutions. In this situation, it could happen that the local banking institutions might also begin to acquire more and more shares in foreign banks, even to the point of outright purchase or mergers.

In view of these trends, many analysts thought it likely that great European banks with a generalized presence in the markets of the main Community countries would arise. So far, however, this process has not taken place as strongly as expected. In the case of Spain, the foreign banks have not managed to seriously challenge local institutions for leadership of the market, even though there are no major restrictions affecting them in this respect. The network of branches of the Spanish banks is a difficult barrier for new entrants to overcome, since they must make heavy investments in order to gain access to their potential clients. In fact, foreign banks have not secured

FIGURE 2
Relations of ownership between banking institutions of Spain, France, Portugal and Italy, December 1999^a



Source: Prepared by the authors on the basis of Cinco Días: Diario de Economía y Empresa, Comisión Nacional de Mercado de Valores, and the Madrid stock exchange.

^a BBVA: Banco Bilbao Vizcaya Argentaria; BSCH: Banco Santander Central Hispano; BCP: Banco Comercial Português, and BNL: Banca Nazionale del Lavoro.

significant market shares in any European Union country. Likewise, no bank of a Community country occupies a leading position anywhere except in its country of origin. Consequently, for the Spanish banks and for most of the other European institutions in their countries of origin, physical proximity to their clients continues to be a clear competitive advantage. It is precisely this feature which justifies the concern over possible hostile takeovers of Spanish banks by their European competitors, since this strategy would give the latter easy access to a leading position in the Spanish banking market.

The launching of the Euro on 1 January 1999 has speeded up changes and reduced time horizons, thus changing the expansion strategies of the main European banks. In a first phase, it is expected that in the next five years mergers will be mainly between banks of the same nationality, since cross-border mergers are more complicated on account of differences of language, culture and tax and regulatory systems. Thus, the leading European banks will try to strengthen their position in their local markets—seeking a minimum critical size—in order to face the continent-wide challenge later. During 1999, af-

ter the formal appearance of the single currency, various large mergers and acquisitions have been announced in a number of countries of the Community (Spain, France, Italy and Germany) for a total

of over US\$ 120 billion.³ If successful, each of these offers would create large national banks that would be in a strong position to compete for leadership in Europe.

III

The internationalization of the Spanish banks: the Latin American option

At the beginning of the 1990s, the banks of the industrialized countries had capital surpluses and were under very strong pressure to reduce costs and take measures to cope with the narrowing of profit margins in their markets –most of them mature and with little capacity for growth–, so that an interesting process of international expansion began to heat up still further (Calderón and Casilda, 1999). The big Spanish institutions went beyond national borders in search of continental- and world-scale markets, both in order to maintain and strengthen their competitive position and in order to defend themselves against possible hostile takeover bids by local or external competitors. In a first stage there was an increase in alliances and collaboration agreements with other institutions, mostly from the Community. In a second stage a rapid and aggressive strategy of expansion into the main Latin American markets was put into effect. The big Spanish banks saw in Latin America the means of consolidating their active internationalization process, based on four main criteria:

- i) the search for greater size and competitiveness;
- ii) entry into expanding markets, with a consequent shift out of mature markets (as the Spanish market was beginning to be);
- iii) exploitation to the full of organizational and technological resources and capabilities; and
- iv) suitable diversification of risks as a function of profitability.

In this sense, the Latin American countries offered a unique opportunity, as the closest options, such as those of other European countries, had mature markets and the possibilities for the acquisition of banks in them were very limited and expensive. Generally speaking, the financial systems of the main Latin American countries were marked by considerable openness and deregulation. Thus, the low

level of development of banking in the region, the broad intermediation spreads, the high potential levels of profitability and the improvements made in bank supervision and regulation systems began to open up interesting opportunities for new business. At the same time, there was a clear lack of capital and of new products to satisfy a growing demand for financial services. For their part, the banks and economic authorities of Latin America took a positive view of the arrival of foreign partners, as a means of overcoming the shortage of finance and thus strengthening and modernizing the local financial systems. All this was heightened by the context of a common language, culture and history, whose absence was a limiting factor in other situations but whose presence in this case favoured the transfer not only of capital but also of technology and management know-how.

In this state of affairs, the Spanish banks secured a rapid and extensive presence in the main economies of the region, leading the way in the increasing penetration of the Latin American financial systems by foreign banks. Between 1996 and 1998 the share of foreign banks in total deposits rose from 16% to 30% (Salomon Smith Barney, 1998). Nearly 60% of loans and 50% of the total worth of the banking systems of the seven biggest economies of the region are controlled to some extent by foreign institutions (Salomon Smith Barney, 1999). Only three such institutions (BBVA, BSCH and Citicorp), however, are

³ In Spain mergers took place between Banco Santander and BCH and between BBV and Argentaria; in France a new institution was formed by the merger of the Banque Nationale de Paris (BNP) with Société Générale and Paribas; and in Italy there were offers by UniCredito Italiano SpA for Banca Commerciale Italiana and by San Paolo-IMI for Banca di Roma SpA. In Germany there were increasingly strong rumours of a possible merger between the Dresdner Bank AG and the Bayerische Hypotheken-und-Vereinsbank AG.

TABLE 1

Latin America: Importance of foreign banks in selected countries, 1998
(Millions of dollars and percentages)

	Total assets	% foreign ownership of assets		Main foreign banks	
		Participation in equity ^a	Effective control ^b	Spanish (% of total foreign banks) ^c	Others
Argentina	160 363	43.2	51.5	BSCH and BBVA (39%)	Bank Boston, Hong Kong and Shanghai Banking Corporation (HSBC), Banca Nazionale del Lavoro, Bank of America, Bank of Nova Scotia, Chase, Citibank, ABN Amro, Deutsche Bank
Brazil ^d	627 395	19.2	21.4	BSCH and BBVA (6%)	ABN Amro, HSBC, Bank Boston, Citibank, Crédit Commercial de France, Sudameris, Lloyds Bank
Chile	108 546	39.4	35.9	BSCH and BBVA (46%)	Bank of Nova Scotia, Citibank, Bank Boston, ABN Amro
Colombia	30 945	21.5	28.8	BBVA and BSCH (59%)	Citibank, Banque Sudameris
Mexico	117 160	19.0	16.0	BSCH and BBVA (33%)	Bank of Montreal, HSBC, Citibank, JP Morgan, Bank of Nova Scotia
Peru	22 074	39.8	58.5	BSCH and BBVA (38%)	Banque Sudameris, Citibank,
Venezuela	22 430	32.4	40.2	BBVA and BSCH (34%)	Bank of Nova Scotia, Citibank,

Source: Prepared by the authors on the basis of information from Salomon Smith Barney, 1998 and 1999.

^a Refers to share of foreign banks in the assets of local institutions.

^b Refers to share in the management of local banking institutions of foreign origin (40% or more of equity owned by a foreign bank).

^c Total assets of banks with Spanish participation, as a share of total assets of all local banks with foreign participation.

^d In Brazil, the State banks continue to be very important. This situation should change in the next few years, however, with the privatization of some of the large State banks.

present in all of them⁴ (Durán, 1999). In recent months, despite the international financial crisis and its effects on Brazil and the other economies of the region, foreign financial institutions have continued to invest in Latin America. At present, the biggest Spanish institutions own almost one-third of the assets of the 20 biggest foreign banks (ECLAC, 2000), which means that they alone exceed the share of the United States banks, which have historically been the leaders in this sector in the region (table 1).

In Latin America, rather than playing their traditional role of accompanying non-financial enterprises

⁴ It should be noted that the main foreign banks in Latin America are not those with the broadest international presence. Twelve out of the 20 leading banks in the region occupy rankings below 50 at the international level (*The Banker*, 1999). Almost two-thirds (65.3%) of the total value of the assets of these 20 banks correspond to European Union countries, while United States banks have a smaller share (29.7%). Participation by foreign banks is most concentrated in the Southern Cone countries and least so in Mexico (ECLAC, 2000).

in their internationalization process by providing them with finance and financial services, what the Spanish banks have done is to carry out an expansion strategy within their main area of activity—commercial banking—by trying to achieve a presence in the largest possible number of markets. With this aim in view, but using different strategies, the main Spanish institutions (BBV, Santander, BCH) have invested some US\$ 10 billion in the region (Calderón and Casilda, 1999). At the same time, the main Spanish institutions have carried out an active plan for diversification and the search for new business in the Latin America. Among the types of new business they have engaged in are investment banking, insurance and in particular participation in pension fund management. In addition, as in Spain, they have acquired minority shares in some non-financial enterprises, basically in sectors where other Spanish investors are very active (telecommunications and energy).

1. Banco Bilbao Vizcaya Argentaria: Can Latin America be a means for seeking a leading position in the Europe of the Euro?

At the end of 1998 the BBV, which is both a bank and an economic group, was one of the most important financial institutions in Europe. As a bank, it was the leader in terms of both assets and profits, while as a financial group it was second in size and first in results (BBV, 1999a). At that time the BBV had 17% of the Spanish market in terms of assets. Early in 1995, it decided to carry out a thorough reorientation of its international strategy, giving a decided boost to its expansion abroad. Now, although 52% of its activities are in Spain, the BBV Group is present in 35 countries, especially in Latin America. The internationalization process has been quite rapid, and the Latin American region has been given growing importance in it. In 1998 Latin America accounted for 25% of the group's total assets, 40% of its branches, and 63% of its total number of jobs, contrasting with only minimal activity four years before.

The BBV's strategy has been to gradually gain management control of the institutions incorporated into it, without insisting on having a majority share of the equity. It has also tended to give priority to consensus and shared management with its local partners (Burns and Weeks, 1998). A central element in the strategy of this Spanish institution has been to position itself at the head of each of the markets, segments and lines of business in which it competes (BBV, 1999a). To this end, it has acted on two fronts: on the one hand, through the overall growth and development of existing activities, and on the other, through a policy of acquisitions which has allowed it to speed up its growth rate in those markets where it has deemed it necessary to make special efforts.

Over the last four years the BBV has expanded all over Latin America. It has made investments in new markets by buying shares in local banks, has strengthened its position in markets where it was already present, and it has increased its controlling shares in various local institutions. In 1995 it took over the management of banks in Mexico and Peru, a year later in Colombia and Argentina, then in Venezuela, and in 1998 in Brazil and Chile (table 2). It has also developed a unified model for the management of different institutions, adapted to the special features of each financial system and each country.

During 1998 the BBV practically put the finishing touches to its positioning phase in Latin Amer-

ica, where it now has a sound and significant presence in the main regional markets. In general, it has invested in leading banks which guarantee minimum profit levels of over 20% (Uriarte, 1997), whose market shares in their respective countries are over 6%, and whose solvency is sufficiently ample (BBV, 1999a). In 1999 the BBV's profits increased by 25% to US\$ 1.2 billion, of which US\$ 274 million came from its operations in the region (an increase of over 70% compared with 1997).

At the end of 1998 the BBV Group's total assets exceeded US\$ 157 billion—twice the gross domestic product of Chile and nearly half that of Argentina—representing an increase of 5.5% over the previous year. This increase was due basically to the incorporation of new acquisitions in Brazil and Chile and expansion in Puerto Rico, which together represented a contribution of US\$ 11.3 billion. These acquisitions meant an increase of over 21% in total assets in the region, which come to over US\$ 43,026 million. However, the evolution of the local currency values of its assets abroad, especially in Latin America, meant a decline of US\$ 6.34 billion in the total assets of the Group (BBV, 1999a).

According to BBV authorities, the Group has not yet reached a fully satisfactory market share in Brazil and Chile. This is due to the fact that it only began to operate in those countries in recent years and to the special features of those markets: the large size of the Brazilian market and the heavy competition on the domestic market in Chile. Depending on the opportunities that arise, BBV will probably make further investments in these two important Latin American markets: indeed, this Spanish group has the capacity to increase its investment in Latin America from US\$ 1 billion to US\$ 1.5 billion in the next two or three years. The group's entry into Mexico, for its part, has become one of the BBV's most successful ventures, in spite of the difficulties through which the local financial market is passing. The BBV Group has invested some US\$ 700 million in capital, infrastructure, technological development and staff training in that country, and has become one of the most solvent institutions in the area (Hernández, 1999).

One of the most important objectives of the BBV's strategy has been to increase its value on the stock exchange. In this respect, the value of its stock has increased more than the average for its main domestic and European competitors, despite the difficult international conditions. This situation has been reflected in the ongoing positive evaluation of this

TABLE 2

Bilbao Vizcaya Argentaria group: ^a
Presence in the Latin American banking market, 1999
(Percentages and millions of dollars)

	Local bank	% ownership	Position in local banking system	Total value of assets, December 1998	Year of entry	Purchase price
Argentina	BBV Banco Francés	60	3	8 859	1996	980
	Corp Banca Argentina	100	20	400	1999	85
Brazil	Banco Excel-Económico (now BBV Brasil)	100	14	5 000	1998	857
Chile	Banco Hipotecario de Fomento (BHIF), now BBV Banco BHIF	55	6	2 960	1998	218
	Banco Ganadero	63	2	3 526	1996	619
Mexico	BBV México (ex-Probursa)	67	5	8 556	1995	365
Peru	Banco Continental	39	3	2 864	1995	156
Puerto Rico	BBV Puerto Rico	100	3	3 580	...	...
Uruguay	Banco Francés	58	...	...	1995	...
Venezuela	Banco Provincial	51	1	4 186	1997	432
<i>Total</i>				<i>43 026</i>		<i>4 500</i>

Source: Prepared by the authors on the basis of information published in BBV (1999a) and in the financial press.

^a Argentaria has had a certain presence in Latin America, mainly in Argentina, Brazil, Chile and Paraguay, with the aim of boosting and financing trade between Spain and MERCOSUR.

Spanish group by international risk assessment agencies. In Latin America, there has not been any reduction in its profit levels in spite of the deterioration in macroeconomic conditions. This is basically because growth of the credit portfolio has been frozen and efforts have been concentrated on ways of obtaining resources from low-cost clients. In other words, there has been greater caution about credit risks and their coverage. There has thus been a big change in the structure of deposits in the BBV's Latin American operations, while strong expansion towards the pension fund management business has continued.

The BBV has a leading position in Spain as regards the management of such funds: its market share is over 14% and it manages assets worth some US\$ 5.3 billion for 467,000 clients (BBV, 1999a). In Latin America, this Spanish bank has found an interesting alternative for diversification and expansion in this activity, because of its great growth potential in the various markets of the region. At the end of 1998, the BBV was the second largest pension fund administrator in the region, with a weighted market share of 25% in the countries where it operates and a leading position in Argentina, Bolivia, Colombia, Mexico, Peru and El Salvador, managing some

US\$ 4,570 million through six pension fund management companies with 4.6 million members.

On 13 May 1999 the BBV further strengthened and consolidated its leading position in Latin America through the indirect purchase of 40.74% of the largest pension fund management company in Chile, Provida.⁵ It thus began activities in Chile and Ecuador and strengthened its position in Mexico, Colombia, Peru and El Salvador (table 3). This operation, valued at some US\$ 266 million, was effected through an exchange of stock between the Chilean group Corp Group Pensions and the BBV. When it was completed, it trebled the assets managed by the BBV in Latin America to US\$ 15.4 billion, with a client base of over 8 million persons, and made the BBV the most important pension fund management company in the region, with a weighted market share of 26% in terms of the assets managed (BBV, 1999b). In October 1999, its share increased still further to 31%

⁵ Provida has 2.4 million members, manages assets worth US\$ 10.2 billion, and has five foreign branches (Colombia, Ecuador, Mexico, Peru and El Salvador). In Chile, Provida accounts for 40% of the members of the pension system.

TABLE 3

**Bilbao Vizcaya Argentaria group:
Presence in pension fund management in Latin America, 1999**

	Local company	% ownership	Position in local market	Total value of assets managed (millions of dollars)	Number of members
Argentina	Consolidar	100	2	2 213	1 297 000
Bolivia	Previsión	72	1	937	250 000
Chile	Provida	47	1	10 200	2 400 000
Colombia	Horizonte	70	2	486	461 000
	Porvenir ^a	20	1	586	841 000
Ecuador	Génesis ^a	25	1	15	87 000
El Salvador	Previsión	51	2	7	134 000
	Porvenir ^a	35	1	23	101 800
Mexico	Profuturo	40	3	514	1 930 000
Peru	Horizonte ^a	75	2	416	511 000
<i>Total, BBV</i>				<i>15 397</i>	<i>8 012 000</i>
Argentina	Siembra	50	1	2 260	2 500 000
Bolivia	Futuro	...	...	...	...
Colombia	...	...	...	...	...
El Salvador	Máxima	50	...	...	...
Panama	...	...	...	...	...
<i>Total Argentaria</i>				<i>4 400</i>	<i>3 500 000</i>

Source: Prepared by the authors on the basis of BBV (1999a); AFP Provida (<http://www.afpprovida.cl>), and Fundación Argentaria (1999).

^a Indirect participation through AFP Provida.

as a result of the merger with Argentaria. According to the BBV's estimates, it spent some US\$ 875 million in order to become the leading pension fund management company.

In addition, as in its market of origin, the BBV has looked for opportunities to invest in the stock of companies not related with the financial area, in which it remains a passive investor. Thus, it is estimated that in the next few years it could invest some US\$ 3.5 billion in emerging Latin American sectors such as telecommunications, energy and other services. At present, it has acquired some stock in Latin American companies in conjunction with companies in which it already has an interest, such as Iberdrola, Telefónica de España and Repsol. Particularly worthy of note is the BBV's participation in the consortium led by Telefónica which has acquired the São Paulo telephone company (Telesp) for US\$ 4,961 million.

To sum up, within a short space of time the BBVA has succeeded in establishing a solid leading position in several of the main lines of business of the Latin American financial sector (commercial banking and pension fund management). Thus, from being a re-

gion where it had almost no presence, Latin America has become a natural extension of the main activities of this Spanish financial group, where it has repeated its corporate strategy and its rivalry with its main competitor in the Spanish market: the Banco Santander. Indeed, even before their merger the BBV and Argentaria had been rising in the scale of positions among the biggest banks in the world: between 1997 and 1998 the BBV rose from 50th to 47th place, while Argentaria rose from 72nd to 67th (*The Banker*, 1999). Moreover, some analysts consider that once it has consolidated its position in Latin America it may begin to redirect its expansion strategy towards the strengthening of its position in Europe. At the end of 1998 the BBV gained control of the fifth largest Italian banking group, the Banca Nazionale del Lavoro (BNL), for US\$ 500 million, and in May 1999 it was selected by the French authorities to form part of the hard core of the Crédit Lyonnais, controlling 3.8% of the equity (figure 2). In early 2000 it is also said to be on the point of securing an alliance –and possible merger– with one of the biggest Italian groups, UniCredito Italiano. Thus, the merger of BBV and Argentaria does not appear to represent any impedi-

ment to its expansion in the southern Euro zone countries and could even further it.

2. The Banco Santander and the Banco Central Hispano: two rivals with different business strategies which ended up merging with each other

At the end of 1998, the Banco Santander had 14% of the Spanish market and was the second largest financial group in Spain. The Grupo Santander is widely represented internationally, with nearly 5,800 offices in 32 countries, serving some 17 million clients. Of the present large Spanish banks, the Banco Santander is that which has carried on its international expansion strategy for the longest time, displaying a marked capacity for innovation and flexibility (Burns and Weeks, 1998) as well as a clear desire to gain control in its overseas operations. In this respect, the extensive international experience and strong leadership exerted by the president of this bank, Emilio Botín, has caused the Banco Santander to prefer to act on its own –without local partners– in its Latin American operations.

Its presence in Latin America goes back to the early 1950s, after which it grew at a modest rate and concentrated on the Southern Cone countries, especially Chile. From 1996 on, however, it embarked on an active strategy of expansion through the acquisition of a large number of banks all over the region. At the beginning of 1996, its operations in the region generated only 8% of the total operating profits of the Grupo Santander, but by the end of 1998 this proportion had risen to over 40%. In 1998 Latin America accounted for 27% of its assets, 30% of its branches and 53% of its employees.

The year 1997 was particularly important for the expansion strategy of the Grupo Santander in Latin America, because in that year it incorporated banks in Argentina, Brazil, Colombia, Mexico and Venezuela into its activities in the region (table 4). This first phase of the Banco Santander's expansion strategy involved the acquisition of half a dozen banks in five countries in a little over a year, for an outlay of over US\$ 3.5 billion. According to some analysts, this acquisition strategy was determined to some extent by the likewise rapid expansion of the BBV in the region. The Grupo Santander was concerned about the fact that the most interesting assets were being snapped up by its competitors –especially the BBV–

thus limiting the available opportunities and driving up prices, so it speeded up its purchase strategy.

In 1998 there were two events which marked the culmination of the first phase of its Latin American expansion strategy: the sale of the 8.8% share that the Banco Santander had in the United States bank First Union Corp.⁶ and the purchase of the Banco do Noroeste in Brazil. The Spanish group used US\$ 1.5 billion of the added value generated by the first-named transaction, plus US\$ 300 million of its profits from the preceding year, to finance its investments in Latin America. With these acquisitions, the Grupo Santander now carries on banking activities in nine countries of the region (table 4): Chile, Puerto Rico, Peru and Uruguay, plus the five countries mentioned in the previous paragraph. Thus, according to executives of the Group, the programme of acquisitions in Latin America is now practically over, and no further major purchase is now envisaged in the short term, although this does not rule out small acquisitions in the financial services industry, in order to increase the Group's capacity in the area of insurance and pension funds or to add further branches to the existing network.

This strategy has also been the subject of criticism, however. Increasing the Group's Latin American subsidiaries from three to nine in a little over one year caused some concern among shareholders. On the one hand it increased the Banco Santander's exposure in an area of higher risk, and on the other it made the management of the Group more complex. However, the executives of the bank have consistently defended the strategy adopted in Latin America and have justified the policy of acquisitions, maintaining that after analysing a large number of banks in the region they selected the best.

The Banco Santander has tried to secure a strong and homogeneous presence in the region. This objective has gradually been achieved, and it only remains for the Group to improve its position in the markets of Brazil, Colombia, Peru and Mexico. According to some analysts, the Banco Santander's operations in those countries are too small to generate a critical

⁶ In 1991 the Banco Santander had purchased 13.3% of First Fidelity Bancorporation, a small New Jersey bank without a nationwide presence, for US\$ 650 million. In June 1995, First Fidelity merged with First Union, and the Banco Santander became the biggest individual shareholder in First Union. In June 1997, the Santander Group sold its share for US\$ 2,160 million.

TABLE 4

**Santander Central Hispano group:
Presence in the Latin American banking market, 1999**
(Percentages and millions of dollars)

	Local bank	% ownership	Position in local system	Total value of assets, December 1998	Year of entry	Purchase price
Banco Santander						
Argentina	Banco Río de la Plata	51	2	9 175	1997	807
Brazil	Banco Santander Brasil (formerly Banco Geral do Comercio)	100	11	...	1997	389
	Banco Noroeste ^a	76	9	9 357	1998	564
Chile	Banco Santander Chile	86	2	9 709	1996	718
Colombia	Banco Santander Colombia	60	6	2 086	1997	236
Mexico	Banco Santander Mexicano	71	5	9 808	1996	500
Peru	Banco Santander Perú	100	6	951	1995	90
Puerto Rico	Banco Santander Puerto Rico	78	2	6 468	1996	366
Uruguay	Banco Santander Uruguay	100	3	740	...	...
Venezuela	Banco de Venezuela	98	3	2 008	1997	380
<i>Total</i>				50 302		4 000
Banco Central Hispano						
Argentina	Banco Tornquist ^b	100	16	1 165	1996	93
	Banco de Galicia y Buenos Aires	10	1	14 100	1998	...
Bolivia	Banco Santa Cruz	90	1	1 336	1998	180
Chile	Banco Santiago ^b	44	1	10 430	1991	294
Mexico	Grupo Financiero Bital (includes Banco Internacional de México)	8	4	10 000	...	37
Panama	Centrobanco Hispano Panamá	100	...	...	...	...
Paraguay	Banco de Asunción ^b	85	5	151	1996	10
Peru	Banco del Sur (Bancosur) ^b	90	5	1 042	1996	71
Puerto Rico	BCH Internacional	100	...	718	...	...
Uruguay	Eurobanco S.A.	100	...	...	1996	8
<i>Total</i>				38 942		1 300

Source: Prepared by the authors on the basis of data from Grupo Santander (1999a), BCH (1999), *Latin Trade* (1998) and the financial press.

^a During 1998 a process of merging the different branches of the Banco Santander in Brazil was begun.

^b The BCH group consolidated its presence in Latin America through its participation in the O'Higgins Central Hispano (OHCH) company. As from 1996, in coordination and joint management with the Chilean Luksic business group, it has carried on activities in Argentina, Chile, Paraguay and Peru. At the end of 1998, the total assets of the banks forming part of the company came to some US\$ 12.8 billion, with US\$ 1,233 million of own funds and a network of 276 offices with a staff of 7,511 persons. On 12 February 1999, the BCH announced that it wished to put an end to its association with the Luksic Group in the OHCH company. The BCH valued the company at US\$ 1.2 billion, of which the Spanish group was entitled to US\$ 600 million. This valuation gave rise to conflicts, because when it merged with the Banco Santander the BCH estimated its share of OHCH at some US\$ 400 million. The Chilean group was given two months to take a decision and finally accepted the US\$ 600 million offered for its 50% share of OHCH.

mass of income (Falcão Filho, 1997). In Brazil, at least in the short term, the Group will have to grow without making acquisitions until such time as there is a major restructuring of the Brazilian banking system. In Mexico—the other great market of the region—the Banco Santander has had some problems associated with the local banking crisis. Now, however, after an injection of capital from Head Office, the Mexican subsidiary is one of the soundest institutions in that country and is getting ready to increase its share of the market as from the year 2000 (Hernández, 1999).

The Banco Santander's strategy has always been to secure majority control of the institutions acquired. It thus has an average share of over 78% of the equity of its acquisitions in Latin America (Grupo Santander, 1999a). Furthermore, by agreement with its shareholders, the institutions acquired in Latin America must have a level of profits of at least 20%. According to the Grupo Santander's own forecasts, however, the profit margins of its Latin American branches are likely to go down significantly as competition increases in the markets of the region. Even so, the Group hopes to increase its in-

come –by raising the efficiency of its Latin American subsidiaries– as the region recovers from the effects of the international financial crisis and growth and economic stability are restored.

Taking advantage of its experience in the Spanish market, the Banco Santander has carried out an intensive campaign to introduce its corporate image, promote its products which have been successful in Spain –such as the SuperCuenta, SuperDepósito, SuperHipoteca and SuperCrédito– and increase its market share in the region. Like other banks which have expanded in Latin America –the BBV and the Hong Kong and Shanghai Banking Corporation (HSBC)– the Banco Santander's high-profile campaign has forced other actors, both local and foreign, to redefine their strategies and commitments, and it has raised the level of competition in a sector which is of crucial importance for the economic health and stability of the region.

Parallel with the expansion of the Grupo Santander, another smaller Spanish bank –the Banco Central Hispano (BCH)– began its internationalization in Latin America.⁷ The basic strategy of the BCH in the region was to secure majority shares in local institutions in association with strategic partners who would take care of the local management of the operations. In 1996 the BCH embarked on an ambitious process of expansion in the region which revolved mainly around its strategic alliance with the Chilean Luksic Group, through its share in the O'Higgins Central Hispano company (OHCH). Thus, the BCH was present in Argentina, Chile, Peru and Paraguay in a 50/50 association with the Luksic Group. In its operations in the region, a particularly important place was occupied by its activities in Chile, where, through the Banco Santiago, it was a leader in one of the most competitive markets of the region (table 4). As a result of financial difficulties and greater competition in its market of origin, the BCH concentrated its efforts on Spain and left the Luksic Group to run the Latin American operations of the OHCH, which incorporated institutions in Argentina and Peru. This financial group thus came to control assets worth some US\$ 13 billion in the region (Sullivan, 1998).

After achieving a rapid recovery in Spain, the BCH began to take a more active part in the OHCH company, seeking to continue its expansion strategy in the region with fresh resources. In March 1998, in order to step up its growth in the region, the BCH announced an increase of US\$ 1,050 million in its capital. Its Chilean associates were reluctant to participate in new acquisitions, however, as they wanted to concentrate their efforts on consolidating the Banco Santiago. In view of the difficulty of finding new partners,⁸ the BCH decided to continue increasing its presence in the region on its own, acquiring substantial packages of shares in the most important banks of Argentina and Bolivia (table 4).

Early in 1999, the BCH merged with the Banco Santander to create a new institution with a different strategic orientation from that which the BCH had previously been applying in Latin America. The top executives of the group finally agreed that the main strategic guidelines of the new institution should give priority to strengthening retail, corporate and business banking in Spain, increasing the contribution of the group's international activities to profits (with special emphasis on the European and Latin American markets), and seeking the ongoing optimization of the group's industrial holdings (BCH, 1999, and Grupo Santander, 1999a). This meant, among other things, the dissolution of the association with the Chilean Luksic Group and the absorption of the assets of the OHCH company by BSCH, which caused some problems of overlapping in regional operations. The growth of the two groups' operations in Latin America has been crucial for their rise in status among the largest banks in the world: thus, between 1997 and 1998 the Grupo Santander rose from 40th to 37th place and the BCH from 107th to 98th (*The Banker*, 1999).

Like the BBVA, the Grupo Santander has not concentrated exclusively on banking proper but has also diversified into other financial activities such as investment banking and pension fund management. In this latter field (table 5), it is the leader in Spain with 15.6% of the market, while in Latin America it manages pension funds worth some US\$ 6 billion in Argentina, Chile, Mexico, Peru and Uruguay, with a

⁸ The BCH did not succeed in persuading the Banco Comercial Português (BCP), its European associate, to join in its expansion plans in Latin America. Indeed, the BCP has even tried to dispose of its 8.5% share in the Banco Internacional: a share which it acquired in association with the BCH, which has an 8.25% share in the Bital Group, the owners of the Mexican bank in question.

⁷ At the end of 1998, the BCH was the third largest institution on the Spanish banking market. Of this "Big Three", it was the least internationalized, having concentrated its efforts in this respect in Latin America, which, in 1998, accounted for 13% of its assets, 11% of its branches and 28% of its employees.

TABLE 5

Santander Central Hispano group: ^a
Presence in pension fund management in Latin America, 1999

	Local company	% ownership	Position in local market	Total value of assets managed (millions of dollars)	Number of members
Argentina	AFJP Orígenes	30	1	1 983	1 460 117
Chile	AFP Summa Bansander	100	4	3 439	426 239
Mexico	Afore Santander Mexicano	100	2	363	1 968 585
	Afore Génesis ^b	100	12	30	141 542
Peru	AFP Nueva Vida	80	5	163	127 338
Uruguay	Santander AFAP	100	4	41	65 105
<i>Total</i>				<i>6 019</i>	<i>4 188 926</i>

Source: Prepared by the authors on the basis of Grupo Santander (1999a).

^a Like other Spanish banks, the BCH sought to diversify into other lines of business in the region, especially pension fund management. With its traditional banking partners, it entered the pension fund management market in Chile (with the Luksic Group) and Mexico (with the Banco Comercial Português), but it did not have a successful experience and in mid-1998 it liquidated its share in the Chilean pension fund management company Qualitas.

^b In July 1998 the Santander Group acquired Afore Génesis for US\$ 27 million, subsequently merging it with Afore Santander.

total of over 4.3 million clients (Grupo Santander, 1999b).

In the mid-1990s the Grupo Santander opened an office in New York with the aim of becoming one of the three main investment banks for business deals related to Latin America and thus complementing the network of banks that it was beginning to establish in the region. It quickly won the confidence of Latin American companies and governments wishing to gain access to international capital markets, but it was not able to take advantage of its strong position in the markets of the region to generate profitable deals in New York (Moore, 1999). It performed well in securities brokerage on secondary markets, despite the low profit margins, but it only obtained rather unsatisfactory results in more profitable operations such as securities issues, going public, or mergers and acquisitions. The Grupo Santander therefore decided to reduce its presence in New York and con-

centrate on its local markets, concluding that there was excess capacity in the field of Latin American investment banking.

Finally, like the BBVA, the BSCH began to step up its expansion process in Europe. At the end of 1999, the BSCH supported the Royal Bank of Scotland (in which it has a 10% share) in its US\$ 40,689 million offer for the National Westminster Bank. If this operation succeeded, the BSCH would obtain 6.5% of the new merged institution and would improve its position in the United Kingdom financial market. In order to finance the operation, it would increase its capital by 4.5%, to be offered to some of its associates already referred to: Société Générale, Commerzbank and San Paolo-IMI. This would enable it to establish closer relations with Société Générale, which would buy most of the new shares and thus gain a seat on the board of directors of BSCH (*Expansión*, 1999c).

IV

An expansion process not devoid of difficulties

In 1998 and the first half of 1999, banking in Spain operated in a dual environment. On the one hand, the Spanish economy was performing satisfactorily, with 4% growth and the lowest interest rates in decades, but on the other hand the worsening of the international crisis due to the situation in Russia and Asia hit the Latin American markets hard. Against this background, the stock exchange value of the biggest Spanish banks (the BBV and the Banco Santander) deteriorated, and this adversely affected their operations in the region to some extent. Despite these adverse conditions, however, both these institutions closed the exercise with good results, attributable above all to their performance in the first part of 1999. By the beginning of December 1998, both banks had recovered and reported increases in profits of 80% and 71% respectively (Durán, 1999). Indeed, the high level of profitability of their Latin American operations has enabled them to cover the cost of a large part of their investments in the region. The top executives of these Spanish financial groups have continued to declare their commitment to expansion in Latin America. Thus, they are expected to embark on a second phase of this expansion strategy, designed to increase the efficiency and competitiveness of their banks in the region.

The stocks of the BBV and the Banco Santander fell by almost 50% between July and September 1998 (figure 3), and the risk rating agencies lowered their forecasts for these banks because of their over-exposure in Latin America. In spite of the strong reaction of the markets, however, these Spanish institutions were apparently prepared for even worse situations (Calderón and Casilda, 1999). In their Latin American banks they maintained an average level of provisions against unpaid loans of over 100%, although in fact the rate of delinquency was quite low: at the end of 1998 the percentage of overdue loans in the region was 5.6% for the BBV and 3.7% for the Banco Santander. In mid-1998 they also put into effect stringent programmes of sound management and reduction of costs.

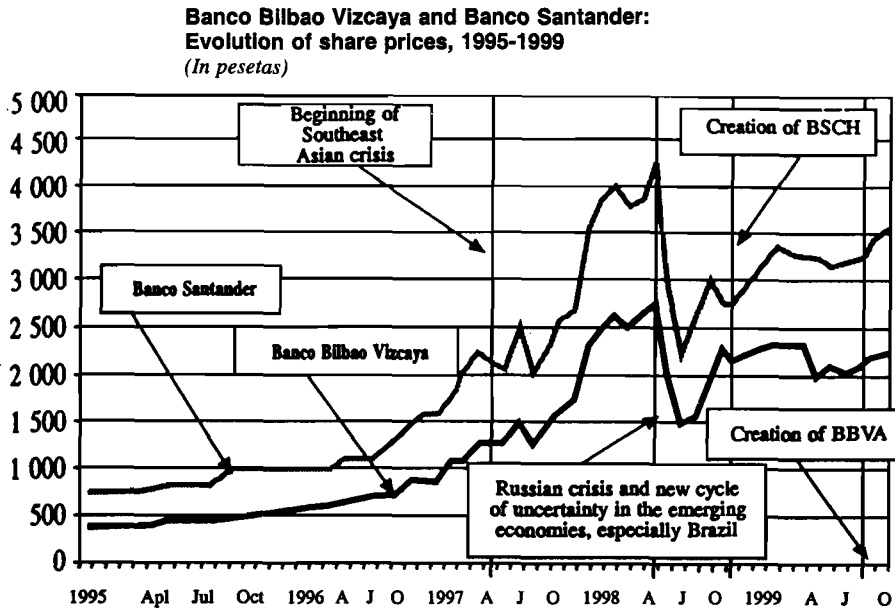
In addition to the reactions of the market, these operations also had their critics inside Spain. The growing importance of the Latin American operations of the country's two main banks gave rise to concern, mainly because of the vulnerability that the economies of the region have shown to upsets on international financial markets. Thus, the Banco de España considered that the two institutions' Latin American acquisitions involved considerable risks, much greater than those deriving from traditional banking operations, and even urged the main Spanish banking institutions to make a very careful evaluation when purchasing new assets and to lay stress on their quality rather than seeking short-term gains.

At the same time, the impending entry into effect of the Euro on 1 January 1999 further heightened the competitive pressures on the Spanish banking institutions. Consequently, as they needed to make adjustments in their global strategy, the possibility of mergers between Spanish banks or with some European partner became more likely.

Thus, on 15 January 1999 the Banco Santander merged with the BCH to form a new institution called the Banco Santander Central Hispano (BSCH). This new bank became the leader in the Spanish market and one of the most important banks at the European level, and its position in the face of future alliances in the Euro zone was considerably strengthened. After this agreement, the BSCH became the biggest foreign financial group in Latin America, leaving the BBV in second place and displacing other long-established banks in the region, such as the United States institutions Citibank and BankBoston and the Dutch bank ABN Amro. At the same time, the merger tranquillized the markets and the stock market value of the new Spanish group began to register a rapid and lasting recovery (figure 3).

According to the financial press, one of the main losers in all this was the BBV, and it was expected to react to these developments. Finally, on 19 October 1999, after nine months of continual rumours, the BBV and Argentaria merged to form a new institu-

FIGURE 3



Source: Prepared by the authors on the basis of information from the Madrid Stock Exchange.

tion: the Banco Bilbao Vizcaya Argentaria (BBVA). With this operation, the Spanish banking system was consolidated around two great institutions, although the BSCH continues to be the leader: in the area of loans it has around 20% of the market, compared with the BBVA's 17%, while in terms of deposits each institution has around 15% of the market (*Expansión*, 1999a). The BBVA also became a very important actor at the European level, with a market capital level slightly above that of the BSCH.

Although the merger complemented and strengthened the new bank's presence in Latin America, it also gave rise to some difficulties: basically, it increased the level of banking concentration and revealed some shortcomings in the regulatory frameworks of the markets in which these institutions already operate or expect to operate in the future. Thus, in some countries of the region the economic authorities are taking a hard look at the dominant position that the two Spanish banks have acquired (figure 4). If it is considered that the degree of concentration affects or harms free competition, they may be obliged to divest themselves of some assets. In markets such as Argentina, Chile and Venezuela, the BBVA has achieved a bigger share than it has in Spain: indeed, this bank and the BSCH have become

the only two banks in the world which have achieved such a position outside their natural market (Calderón and Casilda, 1999).

The most serious problem created by the establishment of the BSCH is in Chile, where the Banco Santiago and the Banco Santander Chile occupy the first and second places at the national level, with a joint market share of nearly one-third (28% of the system's loans), which may be against the anti-monopoly regulations. This case revealed the shortcomings of the national regulatory frameworks for coping with an increasingly globalized international market. At the end of April 1999, the BSCH finally dissolved its alliance with the Luksic Group, which it paid US\$ 600 million for its 50% share of the joint activities in Latin America. With this operation, the BSCH controlled 44% of the Banco Santiago and 86% of the Banco Santander Chile; it also came to an agreement with the Central Bank of Chile to acquire over three years the 34.5% share that the latter had in the Banco Santiago. Furthermore, the Banco de España does not find it very acceptable that a Spanish bank, which it is responsible for supervising, indirectly has 30% of its banking risks in Chile or another foreign country, for this means that any upset affecting the banking market of the host coun-

FIGURE 4

**Banco Santander Central Hispano and Banco Bilbao Vizcaya:
Presence in Latin America, 1999^a**



Source: Prepared by the authors on the basis of Calderón and Casilda, 1999.

^a Numbers in brackets indicate position in the national banking system.

try can affect that bank and, ultimately, the Spanish banking system too.

In these circumstances, the BSCH came to an agreement with the Chilean government and parliamentary authorities in which it undertook to run the two banks it owns in the country separately (the Banco Santiago and the Banco Santander Chile) and to put off a possible merger of the two. It also agreed to reduce its share in the Chilean market, so that its decision as to which of the banks it intends to sell is awaited. This is a complicated matter, as these are

banks worth a great deal of money (US\$ 1.8 billion for the Banco Santiago and US\$ 1.3 billion for the Banco Santander Chile), but it is nevertheless expected that this sale will take place in the short term. Analysts wager that it will opt for strengthening the Banco Santander and carving up the Banco Santiago for subsequent resale. This operation would include the transfer from the Banco Santiago to the Banco Santander of the whole of its 100% compatible portfolio (which should amount to about 8% of the whole), in order to raise the latter bank's market

share by a similar amount. Among possible purchasers would be Citibank and ABN Amro, with the possibility that the BSCH might sell the Banco Santiago to its strongest competitor, the BBV, being almost completely ruled out. Finally, in January 2000 the BSCH announced its decision to reduce its participation in the Chilean market. According to some speculations in the press, the BSCH is preparing to merge the two banking institutions, which would mean an immediate reduction of four points (*El Mercurio*, 2000).

In the case of the merger between the BBV and Argentaria, the situation has been somewhat different (figure 4). This union would not give rise to any major problems in Latin America, because of the almost total lack of any overlapping of the two Spanish financial groups' operations in the region. The BBV has concentrated on commercial banking and, more recently, on pension fund management. Right from the start, Argentaria was unwilling to invest large amounts of resources in the purchase of other banks, so it opted for a line of business which it knew very well and did not involve many risks: private pension fund management.

For the Latin American countries it would be desirable –quite apart from the problems of bank concentration– that this massive entry of foreign banks, and especially of Spanish institutions, should further the achievement of various objectives, including the following:

- Strengthening the local financial systems through the greater capacity of the foreign banks to obtain resources at lower cost on international markets.
- Reducing intermediation spreads through the increase in competition and the fact that the foreign banks are accustomed to working at lower

profit margins (3% in the United States and the United Kingdom, compared with 6.3% in Brazil, for example). If there were such a reduction, the financial costs of borrowers would also be reduced.

- Increasing competition and reducing operating costs, which would oblige the local banks to raise their efficiency in order to reduce their vulnerability.
- Increasing the level of financial intermediation through a greater supply of new and more sophisticated products from the institutions operating in local markets.

So far, the most obvious result has been the strengthening of local markets, which, in the face of two large-scale international financial crises (in late 1994 and mid-1997), have shown themselves to be less vulnerable than in past crises (especially the external debt crisis). Perhaps the most difficult case continues to be that of Mexico. With regard to the benefits of increased competition and their transfer on to clients, the results have been varied. In general, the intermediation spreads of foreign banks in their Latin American operations continue to be high, unlike the spreads in their markets of origin, and although operating costs have been sharply reduced the cost of credit has not gone down significantly.

To sum up, in a setting which has undergone many changes the internationalization strategy of the main Spanish banks has given rise to heated controversy. In Latin America, Spain and the European Union, the political and economic authorities, businessmen, shareholders, markets and clients have all expressed their different points of view about the unprecedentedly rapid and far-reaching phenomenon of the expansion of the Spanish banks in the main areas of business of the Latin American financial sector.

V

Conclusions

After more than ten years of a broad-ranging and extensive process of liberalization and financial deregulation, the situation in the Latin American banking, insurance and pension fund markets has been completely changed by the massive presence of global financial institutions. The great Spanish banks have

been central actors in this process and have become leaders in most of the countries and segments of financial business in the region (figure 4). In the early 1990s, these banks, together with some public enterprises such as Telefónica and Iberia, led the process of internationalization of Spanish business. Now, the

Spanish banks come to Latin America for their own interests rather than those of their clients, and the Spanish public enterprises which are most active in the region have been totally privatized.

The international financial crisis which began in 1997 and its strong impact on the region –particularly in Brazil– did not alter this trend, for the international banks continued to increase their presence in the markets of the region (figure 4). Firstly, many of the small and medium-sized banks in Latin America have not been able to adapt to the new situation, which could mean their disappearance or acquisition by foreign companies, and secondly, some of the larger institutions have sought the financial support of important foreign companies in order to be better prepared for the expected increase in competition in the years to come.

In general terms, the first stage in the expansion of the big Spanish financial institutions in Latin America is now over. In the main line of business, commercial banking, the BBVA and the BSCH both occupy similar positions, with a strong presence in most of the markets of the region. The main unfinished business for them is their expansion in the Brazilian market and, to a lesser extent, that of Mexico. They have also embarked on an active process of diversification, combining investments in banking with others in insurance, in pension funds, and more recently in private health systems.

The strong impact that the growing exposure of the main Spanish banks in Latin America has had on their stock market value has forced them to make some adjustments in their internationalization strategy. In Latin America, in view of both the reduction in profit margins due to the stronger competition and

the more marked relative external vulnerability of those markets, they have had to apply active programmes to put their branches in the region on a sounder footing and improve their productivity, and in Europe, as a result of the increase in average sizes and in competitive pressures, the Spanish banks appear to be embarking on an expansion strategy which will put them in a better position to cope with future developments in this common market.

From the Latin American standpoint, the entry of foreign banks, and especially of the Spanish institutions, has helped to stimulate and modernize the financial systems of the region. In general, the foreign institutions have introduced new instruments and technology, have increased the levels of competition –with direct effects on the availability and cost of credit– and have made the local financial systems stronger and more stable. They have also brought some difficulties, however, such as the increase in concentration and the slowness with which the benefits of the greater competition and efficiency of the Latin American financial markets have been passed on to clients.

This broad presence of the Spanish banks, together with the active expansion of Spanish non-financial enterprises in the main Latin American markets, has caught the attention of regional and multilateral agencies, and at the same time it has shown up the limitations of national regulatory frameworks for coping with the increasing globalization of international markets. Thus, decisions taken in Europe affect users in Latin America and elsewhere, giving rise to reactions at various levels whose final results have yet to be seen.

(Original: Spanish)

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Hirschman's view of *development, or the art of trespassing and self-subversion*

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This article analyses the work of Albert Hirschman from the standpoint of two basic concepts: trespassing and self-subversion. Hirschman turned these exercises into an art, pleading his case in a manner which combines curiosity and intellectual humility. In a world accustomed to think and think of itself through totalizing models, in a continent where so many ideological models which sought to open up (or rather, force open) the realities of countries were put together and taken apart, Hirschman's works and intellectual attitude represent a healthy and beneficial invitation to take a different view. This is not his only merit, however. From Chile to Brazil, from Mexico to Argentina, he passed on his passion for the possible to more than a few admirers. In the last few years, a great many ministers, academics and leading members of international organizations have repeatedly praised his contributions. Likewise, many of the concepts developed by Hirschman –his “exit, voice and loyalty” triptych, the notion of the “tunnel effect”– and above all his propensity to think in terms of the possible and his efforts to trespass over and subvert theories (including his own), paradigms and models, and all the cubist and minimalist mental exercises that are constantly created and recreated, are healthy sources of inspiration and interpretation for rethinking the never-ending quest for development. Lastly, notions like community participation or social capital, which are now major subjects of discussion, can also be better appreciated, subverted and self-subverted in the light of Hirschman's work.

I

Introduction

"Trespassing is often used in a negative sense in the United States: for example, in notice boards that say "No Trespassing!", viewing it as a violation of private property, but in my view it can have a positive value: it can mean stepping over the borders between one discipline and another, without seeing them as rigid divisions. My last reversal of the accepted meaning is that of "subversion", which is also generally used in a negative sense: "subversion? How terrible!"

Albert Hirschman¹

In one of his most famous essays, Isaiah Berlin suggests dividing thinkers into two categories: hedgehogs and foxes (Berlin, 1979). That great philosopher aimed to include all intellectuals in that very original classification, inspired by a fragment from the Greek poet Archilochus: "The fox knows many things, the hedgehog only one thing, but on a grand scale".

The hedgehogs are those who develop an all-embracing view of the central world: a coherent system for analysing and thinking the whole of their experiences and ideas. The foxes, in contrast, live, think and act without trying to locate their lives, ideas and actions within a coherent global system: a totalizing view of the world. Beyond any doubt, in the light of his work and life, Albert Hirschman belonged among the foxes: a tremendously free fox

who kept on running incessantly, crossing both mental and real boundaries, intellectual and physical frontiers, multiplying different views of the world, constantly engaging in subversion and self-subversion, always trying to swim against the current, no matter how fierce the ideological storms to be weathered.

In the 1930s, fleeing from Nazi Germany, he crossed any number of real frontiers, journeying all over Europe and studying in France (where his dream was to study *Sciences Po* but he finally entered a French business school)² and in England (at the London School of Economics), before finally going to Trieste in Italy and fighting against the fascists, first in the French army and later in the U.S. forces. After that, he crossed the Atlantic to settle in the United States, where he had a brilliant university

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¹ "Albert Hirschman. Entrevista sobre su vida y obra", in IDES (1996, p. 658). See also Hirschman's last book, *Crossing Boundaries*, whose title reflects his defence of these views and his very special intellectual makeup, with his propensity for subversion and self-subversion (Hirschman, 1998).

² As Hirschman himself humorously confessed when receiving an Honorary Doctorate in Political Science in April 1989: "You will now understand why today's ceremony has a special, sweet savour for me: sweet as revenge can be. After fifty-six years and a number of most unlikely detours, the doors of Sciences Po have finally swung open for me: a fairy tale come true! My heartfelt thanks for this happy end!" (Hirschman, 1995a, p. 115).

career at Columbia, Yale, Harvard and Princeton. A tireless traveller, in the 1950s and 1960s he kept on crossing frontiers, living for some years in Colombia, to which he returned on several occasions and which inspired his first great essay on the economics of development: a master-work which continues to this day to be a classic of the economic literature.

His Latin American experiences –in Chile, Brazil, Peru, Uruguay, Ecuador: indeed, all over the continent– kept on increasing, turning Hirschman into the most “European” of United States Latin Americanists. As time went by, his ideas also began to spread to other areas of the mind, and his works gradually crossed the frontiers of a number of other disciplines, starting with economic science and extending to moral and political sciences. As from the 1970s, after having been responsible for one of the greatest attempts to subvert the then prevailing theories of development and one of the most amazing attempts at the self-subversion of his own theories, Hirschman ventured off in other directions. His new mental journeys led him to formulate original ideas not only on the economics of development but also on the history of ideas, on the links between economics and politics, and, in his last essays, on art, joy, and the significance (not only economic but also political) of sharing a banquet.

Trespassing and self-subversion: Hirschman turned these exercises into an art, pleading his case with a combination of curiosity and intellectual humility. When he makes a critique of the dependency school, for example, he does so on the basis of a critique of his own theories which he had defended in the past.³ His repeated efforts to avoid being put in any type of classification, to avoid being enclosed in a globalizing paradigm which pretends to be the master key to the understanding of all political, eco-

nomical and social realities, are hailed today both by academics and development operators. Nevertheless, the fox keeps on running: Hirschman continues to reject all attempts to canonize his ideas or reduce his works to a single “great central idea”, even if that great idea were to reject the whole notion of great ideas.⁴ In a world used to thinking and thinking of itself through totalizing models, whether they be called “dependency theory” or “Washington Consensus” (*modelos para armar*, as Cortázar would have said), and in a continent where so many ideological models which sought to open up (or rather, force open) the realities of countries have been put together and taken apart, Hirschman’s works and intellectual attitude represent a healthy and beneficial invitation to take a different view.

This is not his only merit, however, as we shall see below. From Chile to Brazil, from Mexico to Argentina, he passed on his passion for the possible to more than a few admirers. In the last few years, a great many ministers, academics and leading members of international organizations have repeatedly praised his contributions. Likewise, many of the concepts developed by Hirschman –his “exit, voice and loyalty” triptych, the notion of the “tunnel effect”– and above all his propensity to think in terms of the possible and his efforts to trespass over and subvert theories (including his own), paradigms and models, and all the cubist and minimalist mental exercises that are constantly created and recreated, are healthy sources of inspiration and interpretation for rethinking the never-ending quest for development. Lastly, as we shall also see below, notions like community participation or social capital, which are now major subjects of discussion, can also be better appreciated, subverted and self-subverted in the light of Hirschman’s work.

³ See Hirschman (1986c and 1978) and also Hirschman (1968), republished in Hirschman (1971a).

⁴ See, in this respect, McPherson’s article on “The social scientist as constructive skeptic: On Hirschman’s role” and Hirschman’s response, “A propensity to self-subversion”, both included in Foxley, McPherson and O’Donnell (1986).

II

Journeys from economics to politics and beyond

From the point of view of the history of ideas and of development economics, Hirschman's intellectual work is original in a dual sense. It is at once a central yet also a marginal body of work. Central, because his reflections on development economics, from the publication of *The Strategy* in 1958 up to *A bias for hope* in 1971 (including *Journeys*, in 1963), his reflections on unbalanced growth, and his concepts of backward and forward linkages have become inevitable pillars of discussions on economic development (Hirschman, 1958, 1963a and 1971a). Marginal, because in the mainstream thinking of his home discipline, economics, Hirschman became a highly appreciated but marginalized voice, considered to be "out of the game" (that is to say, outside game theory). He remained on the sidelines of the paths which were later to become superhighways for economists, econometrics, formalization and the paradigm of the "rational actor".⁵

However, even though the defeat suffered by development economics, as Krugman notes,⁶ was not so much empirical or ideological as methodological (because this branch of economics became dominated by a discursive and non-mathematical style at a time when formalization was advancing rapidly in all the other branches), Hirschman fully accepted his intellectual exile. His marginalization from this discipline—similar to that of some other development economists, such as Myrdal, for example—was voluntary: Hirschman simply opted out. He ceased to run along the superhighway (which he had travelled at one time) and left it to travel along other paths and enjoy scenery which was not as smooth and level as that of the mathematical formalizations but was much more colourful, with its economic aspects enriched by political and moral dimensions, and vice versa.

Returning to the origins of political economy, to Adam Smith before *The Wealth of Nations*, when he wrote *The Theory of Moral Sentiments*,⁷ Hirschman constantly insists in his work on the changes in individuals' preferences, sounding their passions and interests (Hirschman, 1991) and their propensities to mobilize in common causes and undertake collective action or, on the contrary, to withdraw into the private sphere (Hirschman, 1982). The topography of economic science, as reflected each year in the award of the corresponding Nobel Prize, indicates that this type of actor, who recurs throughout Hirschman's work, may be having better luck now (or at least not being so completely forgotten). Economists like Ronald Coase and his theory of transaction costs, Douglass North and his economic institutionalism, or Amartya Sen and his economic ethics represent a type of actor closer to that defended by Hirschman than to that preferred by Becker.⁸ Likewise, in the area of international political economy or development economics, studies are now coming out which combine *esprit de géometrie* with *esprit de finesse* and, as Hirschman would say, "complicate" the economic discourse. One example, among many others, is that of the studies of Rodrik.⁹

⁵ For an epistemological analysis of this evolution towards growing formalization, see McCloskey, 1994.

⁶ See Krugman (1994 and 1992). See also Hirschman's own essays on the evolution of development economics (especially Hirschman, 1981b).

⁷ Smith, 1776 (originally published in 1759). As Ronald Coase (Coase, 1976, pp. 545-546) says in one of his essays, it is a mistake to believe that Adam Smith saw mankind as an abstraction, as an "economic man" whose only aim is to pursue his own interest: Smith would not have considered it reasonable to treat a man simply as a maximizer of rational benefits. Curiously enough, this work by Smith was less successful and less well-known than *The Wealth of Nations*. For example, its translation into French has been out of print since 1860, when the translation made in 1789 by Sophie de Grouchy, Marquise de Condorcet, was republished.

⁸ Amartya Sen, in particular, expounded at length throughout his work on his concept of the economic actor, criticising the neo-classical and utilitarian view of actors as rational fools in a very well-known article (Sen, 1977); see also Sen, 1987. A more classical view of the economic actor may be found, for example, in Gary Becker's speech when he received the Nobel Prize (Becker, 1996) and in Stigler and Becker, 1977.

⁹ See, for example, the most recent essays by Rodrik (1998a) or the studies assembled in Sturzenegger and Tommasi (eds.), 1998.

III

From being a good revolutionary to a good liberal?

What is beyond any doubt is that during the "lost decade" Hirschman's work won a special *cachet*, particularly in Latin America and among academics and development operators in general.

From the 1980s on, there are abundant tributes to his work: tributes which in no way represent a form of "totemization" of his figure, as Foxley, McPherson and O'Donnell (1986) make clear in the introduction to their book on Hirschman's thinking. Indeed, when there were attempts at "totemization", Hirschman himself energetically rejected them, as he did in his address at the meeting held by the World Bank in the early 1980s to pay homage to the pioneers of development.¹⁰ In April 1984, a congress devoted entirely to Hirschman was organized in the University of Notre Dame. In November 1989, with the support of the IDB, another international congress was held at the Instituto Torcuato di Tella, in Buenos Aires, which issued an invitation to rethink development strategies in the light of Hirschman's thinking.¹¹ Other meetings followed, such as those at ECLAC, or at MIT, where an important meeting of economists was held to re-examine development experiences in the light of his work.¹²

These (re-)encounters were also sometimes expressions of gratitude not only for the work of a thinker but also for the efforts made by a man who devoted time and energy, in the most difficult moments of the military dictatorships, to supporting Latin American democrats and the intellectuals and institutions of the region. With the return of democracy to Latin America, many of those intellectuals likewise returned to leading political and economic positions. For this reason, this "rediscovery" of

Hirschman in the 1980s is not only something which is important from the point of view of the history of ideas, but also from that of the practical application of political economy. Many of those intellectuals who took the opportunity to express their gratitude to Hirschman and the debt they owed to him did indeed become ministers or even presidents of newly democratic republics in the late 1980s and the 1990s. Among those who participated in some of the meetings in question were, for example, the former Minister of Finance of Chile and now Senator, Alejandro Foxley, and the important Brazilian personalities Fernando Henrique Cardoso (now President of Brazil), Pedro Malan (Minister of Finance) and José Serra (Minister of Health): the last-named person was a research assistant of Hirschman in the Institute for Advanced Studies in Princeton, while he was completing his Doctorate at Cornell University.

During the "lost decade" Latin America nevertheless gained something that was very valuable. Thus, the continent underwent a conversion to possibilism.¹³ Sometimes voluntarily and deliberately, but other times without knowing or wanting it, like Monsieur Jourdain in Molière's play, economic policies became eminently pragmatic. Chile, perhaps more than any other country, is a good illustration of this great transformation in Latin America. That country went through a "torrent of paradigms", moving from a "revolution in liberty" to a "socialist revolution" and then changing once again to a "liberal revolution". As from the 1980s, however, economic policies became more pragmatic, and the country built up a store of "heterodox approaches". Like other countries of the region, Chile did not in fact move from the paradigm of the "good revolutionary" to that of the "good liberal": what sank into crisis in the 1980s was precisely the "policy of the impossi-

¹⁰ Especially when those attempts were based on erroneous interpretations of his theories (Hirschman, 1984, p. 104 et seq.).

¹¹ All these meetings gave rise to essays which were collected in Foxley, McPherson and O'Donnell (eds.), 1986, and in Teitel (ed.), 1992.

¹² This meeting gave rise to a publication which has already been mentioned earlier (Rodwin and Schön (eds.), 1994).

¹³ For a defence and illustration of this theory, see Santiso (1997).

ble” –the idea of promoting economic policies formulated and implemented on the basis of intangible macro-paradigms.

Thus, in the early 1980s the land of the Chicago Boys, which had been presented as the lair of neoliberalism in the region, nationalized its banks and thereby patently illustrated Hirschman’s idea of the unintended consequences of human actions and the importance of possibilism in economic policy. As Carlos Díaz-Alejandro wrote with regard to that period, “the clearest example of this paradox is Chile, which, though guided by capable economists committed to *laissez-faire*, has shown to the world a path which is more in the direction of a *de facto* socialized banking system. Argentina and Uruguay display

similar tendencies, which are also clearly discernible in other developing countries” (Díaz-Alejandro, 1986). Years later, when the Chicago Boys stepped down with the fall of the military regime, the new authorities in Chile, instead of repudiating the economic legacy of that regime in the field of economic engineering and reform, have continued to combine privatization with regulation and openness to trade and capital flows with controls on capital (through the famous system of compulsory reserves which was eliminated in 1998, when everybody was pointing towards that model as the way to go in order to prevent contagion with financial crises),¹⁴ thus toning down the idea of growth with equity in line with possibilism.

IV

A passion for the possible

We could give many more examples of this turn towards possibilism which has taken place and continues to take place in the region. As Hirschman himself said in his last essay, on the evolution of development economics in Latin America (illustrating his ideas with examples from Argentina, Brazil and Chile): “In an earlier article, I talked about contrasting switches from one set of beliefs to another. This time I am concerned with a more fundamental, if less easily defined, shift from total confidence in the existence of a fundamental solution for social and economic problems to a more questioning, pragmatic attitude –from ideological certainty to more open-ended, eclectic, skeptical inquiry” (Hirschman, 1987).

The fact that Hirschman’s work has now taken on renewed importance is due precisely to the fact that a very profound change has taken place in Latin America in the last few decades. The ideological disarmament which culminated with the fall of the Berlin Wall in 1989 also brought into question a certain cognitive style which was particularly clear in the discussions and actions for promoting development, especially in Latin America: a style described by Hirschman in his essays (on the basis of his observations of concrete cases in Brazil, Colombia and Chile in the late 1950s and early 1960s) as “rupturist” and centered essentially on glimpsing re-

ality through a prism of paradigms: a non-incremental style of political economy made up of repeated failed attempts which gave rise to a complex of failure and a leaning to pessimism, an obsession with failure which it was sometimes sought to overcome through ideological escalades involving what Hirschman called *la rage de vouloir conclure* (an urge to get things finished): attempts to speed up development through “pseudo-creative answers”, integrated, definitive and rapid solutions which took no account of possible cumulative sequences or the lessons of experience.¹⁵

The magic key for opening the door of the paradise of development was never found, possibly because for many years the idea was to find a single master key that would open all doors. An attempt was made to apply the same recipe –sweet or savoury, depending on the culinary fashion of the moment– to all the countries of Latin America, in accordance with the guiding light being emitted by

¹⁴ With regard to these economic policies in particular, see Edwards and Lederman (1998), and with specific regard to controls on capital, see Edwards (1998).

¹⁵ See the masterly essay “Problem solving and policy-making: A Latin American style?” (Hirschman, 1963b).

some far-off economic lighthouse of the North, and to serve all the countries of the continent the same highly ideologized dishes, originally warmed-up in some distant American or European university: dishes that were successfully and cunningly reheated on numerous occasions for the more tropical or mountainous climes of Latin America.

There are no absolutely suitable development sequences: some are simply worse than others, depending on the local context. There are no systematic links between political democracy and economic development,¹⁶ nor global laws of change which are

valid for all. Perhaps it would be better, adds Hirschman, to eschew supposedly ideal sequences and opt instead for a type of reformism which is not only cumulative but also adaptive: "looking for uniform solutions to development problems invariably leads us astray; this is so for the imperatives of simultaneity and sequentiality alike, for the insistence on integrated planning as well as for the injunction to postpone certain tasks in the name of one thing at a time. With this conclusion I can lay claim to at least one continuity in my thought: the refusal to define one best way" (Hirschman, 1990).

V

A little more reverence for life

One of Hirschman's *leitmotivs* ever since the *Strategy* is that individuals and institutions become actors in development if they participate actively in it: that is to say, they do not only participate reactively but also creatively. For Hirschman, the most important thing is learning by doing. Successes and failures are both valuable paths of learning; the obstacles standing in the way of development can become vectors to it, and there are blessings in disguise and unintended consequences that stem from what might at first sight seem a failure or obstacle.¹⁷ Likewise, Hirschman argued that in some cases development can be achieved without having predetermined objectives or a full knowledge of how to attain them. Indeed, the lack of knowledge can be a blessing in disguise: if the institutions or individuals involved in development projects were aware of all the difficulties that they would have to cope with, they would probably decide to give up, or not even to start trying. This is the famous principle of the hiding hand which he proposes in one of his essays, referring indirectly to Smith's "invisible hand" (Hirschman, 1967).

This explains his ongoing interest and preference for small changes and gradual transformations, which have only come to be viewed as such because we have got used to living in a world that favours spot comparisons, reduces distances and compresses time. These mechanisms enormously encourage and amplify the obsession with failure: a kind of complex of impotence in the face of the work to be done and the journey to be made (Hirschman, 1981c). It also explains his repeated insistence on greater acceptance and consideration of actual situations and experiences. "In all these matters", writes Hirschman with respect to development economics, "I would suggest a little more reverence for life, a little less straitjacketing of the future, a little more allowance for the unexpected –and a little less wishful thinking" (Hirschman, 1971c).

This involves a broader concept of who the actors in change are (not just the "developers" but also the "developed"), with fuller and better participation by its main beneficiaries. Studies of concrete cases confirm the greater effectiveness of participative programmes. According to a World Bank report on 121 projects for providing rural areas with drinking water, the projects with a high degree of participation (21% of the total) registered levels of up to 81% in efficacy and achievement of their objectives, while the projects with a low degree of participation (31% of the total) only had a level of efficacy of 3%.¹⁸ The

¹⁶ See in this respect the clear views expressed in Hirschman (1994). For an analysis based on more quantitative data, see also the essays by Rodrik (1998b), Przeworski and Limongi (1997) and Barro (1996) and the important works by Alesina (1997), Tavares and Wacziarg (1996) and Alesina and Perotti (1994).

¹⁷ These ideas were developed in an introduction to possibilism (Hirschman, 1971d).

¹⁸ See the examples cited by Kliksberg (1998).

participative municipal budgeting project in Porto Alegre, which has become an international reference model, also confirms this greater effectiveness of participative projects, even when they involve large groups of people (1,300,000 persons in this case). Community participation, in both the identification of problems and the selection of priorities and evaluation of results, made it possible to allocate resources more efficiently. Thus, between 1989 and 1995 the coverage of drinking water supply rose from 80% to 98% and that of sewerage systems from 46% to 74%.¹⁹

Substantial results were also obtained in a participative rural preventive health project carried out in Ceará (in the Northeast of Brazil) from 1987 on: infant mortality was reduced by 36% (from 102 per thousand to 65 per thousand) and the rate of coverage of vaccination rose from 25% to 90% of the population.²⁰ Finally, in the Villa El Salvador project in Peru, through a major community effort it was possible over a period of two decades to construct much of the necessary physical infrastructure in a settlement established on a stretch of sandy wasteland outside Lima. Altogether, the inhabitants constructed over 38,000 dwellings, 60 community centres, a similar number of educational centres, and 41 integrated public health and educational centres. It was also possible to reduce illiteracy drastically to only 3.5%, which is well below the national average.²¹

Another important aspect noted by Hirschman is that it is not only the concrete obstacles to change that prevent people from following the paths to development; in many cases it is the obstacles represented by the "perceptions" of change that prevent this (Hirschman, 1971b). The obsession with "reforms from above", with macro-reforms that promise a great leap forward rather than a mere step ahead, increases the risk of disappointment, in some cases because the goals are hard to achieve, in other cases because the dazzling leap forward that was announced turns into an embarrassing fall or the initial energetic impulse gets bogged down in a mass of un-

foreseen impediments. This propensity causes a kind of cognitive fog which covers up or blurs the authorities' vision of past examples and future possibilities not only of "reforms from below" but also of the valuable lessons that can be drawn from concrete experiences. This is why it is essential not only to be aware of past examples of successful development but also to disseminate them, to highlight possibilities, and perhaps help in this way to self-subvert some of our most deeply-rooted beliefs.

These considerations have some practical consequences. Firstly, dynamically involving the beneficiaries of development programmes means not only ensuring their participation in the implementation of the programmes but also integrating them *ex ante* into the design process and *ex post* into subsequent control and evaluation. Like the samba or the tango, development is not something one can learn by correspondence. It requires a shared process of active and retroactive learning by doing. Likewise, development cannot be danced alone: it calls for a couple – "the developer" and "the developed" – who learn by doing: they learn about themselves, about their partner, and about the action which has been outlined, implemented and evaluated between them, so that both of them thus increase their accumulated store of knowledge: their *savoir faire* and *faire savoir*. Finally, the dance of participative development also means respecting the three steps in the participation process: one, the preparation of the list of priorities; two, the implementation of the sequence thus established, and three, the evaluation of the achievements, errors and omissions. In each of these three steps there must be discussion and negotiation between the two partners.

Participative processes undoubtedly involve difficulties and costs: in terms of time, for example, decisions and actions may take longer. However, their virtues outweigh these disadvantages not only from the point of view of operational efficiency but also in terms of economic ethics, for as the recent studies by Alesina (1997) and Boone (1994) show, there is a considerable waste of outside aid when there is an increase in the number of intermediate links (Alesina and Dollar, 1998). Ensuring greater participation by the final beneficiaries means ensuring a form of development which really does benefit them rather than the intermediaries. Furthermore, involving the population not only from the beginning of the project but also from the stage of its conception and preparation makes it possible to weigh not only its economic but

¹⁹ For details of this experiment in participative democracy, see the doctoral thesis by Marques (1997).

²⁰ See, in this respect, Tendler and Freedheim (1986 and 1994) and, in particular, Tendler (1997).

²¹ With particular respect to this case, see Franco (1993).

also its political and social impact: how will outside aid change the local political balance? how will it affect individual social capital? how may it consolidate or, on the other hand, adversely affect the social cohesion of the community?

Secondly, making known successful examples allows the range of possibilities to be expanded. It makes it possible to introduce a bias for hope and to pay greater attention to unexpected effects which might otherwise have remained concealed, covered by the mantle of theories and theorems. Above all, however, making successful past experiences known makes possible feedback in the learning process. Cognition is also recognition. Not only should there be external publicity, but also internal publicity, both inward and outward, aimed both at the community of “developers” and at the communities of “developed”. In many cases, one learns by doing, inventing and imitating. Making experience known means opening up other possibilities of learning through imitation: when one learns about other people’s experience one can try to imitate or repeat them, to invent new things on the basis of them, to take another step forward, to improve on what has already been done.

Both the Ceará project in the Northeast of Brazil and the Villa El Salvador project in Peru illustrate the virtues not only of community participation but also of “cognition which is recognition” –knowledge

which is acknowledged by others who come after. In both these cases, a participative learning process was set in motion which contained components of promotion (by the “developers”) and imitation (by the “developed”). Above all, however, these examples display imitative components. Both projects have received world awards: the Villa El Salvador project received an award from UNESCO, in addition to the “Príncipe de Asturias” prize, while the Ceará project received the Maurice Paté Prize from UNICEF. These awards gave a shot in the arm both to cognition and to recognition and raised the individual and collective self-esteem of all the participants, strengthening their degree of involvement and encouraging other similar actions. A major exercise of living memory remains to be carried out in order to identify, document, review and disseminate these successful experiences and increase the stock of accumulated and shared knowledge. This could be achieved through, for example, the award of an international prize. As Bernardo Kliksberg notes, the establishment of a prize of this kind in Canada led to the submission of 68 applications. This proposal could be self-subverted by also ensuring feedback based on unsuccessful experiences, where the award would be made for the relevance of the analysis in question or the indication of a possible solution to the problem thus revealed.

VI

Social capital, concord and discord: the social virtues of times of sharing and of conflict

One of the central themes in Hirschman’s last essays is that of the shifts in human actions between private interest and public action. In a first essay, the division between the two spheres was categorically asserted. Hirschman’s aim was to understand how people passed (trespassed) from one sphere to the other and what were the final motives of those shifts in preferences (Hirschman, 1982). In later essays he gradually toned down this dichotomy, ending up by self-subverting his thesis and showing how the two spheres could merge and combine with each other

(using in particular the example of public banquets, as we shall see below). These last essays offer some particularly stimulating ideas that could enrich the current debates on social capital.

Hirschman does not mention the notion of “social capital” directly.²² He only mentions it on one occasion, and that is in an essay devoted not to the

²² Indeed, this is a concept which is hard to catch in the conceptual net. See Santiso, 1998.

virtues of cooperation but to those of social conflict.²³ In his essays, Putnam stresses the virtues of social capital such as the links of confidence that individuals forge with each other and the propensity to cooperation and peaceful coexistence. Similarly, the essays corroborating the existence of correlations between economic performance and the density of associative life and the confidence in themselves and in others that individuals in different societies possess are presented ultimately as a more elaborated version of the old theory of *le doux commerce*.²⁴

Hirschman invites us to indulge in a healthy exercise of self-subversion. It is perfectly true that horizontal or vertical links of confidence between individuals, or between them and institutions, are essential for cementing coexistence. Likewise, as Knack and Keefer point out, a high level of mutual confidence allows individuals to reduce the time and cost involved in protecting themselves against the possible risks arising from commercial or non-commercial transactions with others.²⁵ However, just like concord, discord can also foster social capital. Conflict and discrepancy, says Hirschman, may be even more effective in creating social capital than the peaceful cooperation referred to by Putnam, and they may also finally be more relevant indicators of the vitality and cohesion of a society. "The secret of vitality", writes Hirschman, "of pluralistic market society and of its ability to renew itself may lie in this conjunction (of both bargaining and arguing) and in the successive eruption of problems and crises". [society] "cannot pretend to establish any permanent order or harmony; all it can aspire to accomplish is to 'muddle through' from one conflict to the next" (Hirschman, 1995a).

In order to understand the mechanisms of the creation of social capital, then, we must pay due attention to conflicts. We must discriminate between conflicts which create such capital and those which

destroy it; we must combine quantitative and qualitative analysis in order to measure the real importance of this virtuous conflict, and we must take account not only of the quantity but also the quality of conflicts. Although it is necessary to analyse in economic, political and moral terms how societies ensure coexistence (by sharing time, for example, attending a concert or visiting a café,²⁶ sharing attendance at a play or sharing a coffee in a public place), it is also necessary to gain a better understanding of the institutions and mechanisms that regulate social conflicts in Latin America. At the national level, democratic regulation mechanisms are one example, while judicial mechanisms are another. All of these have to do with vertical confidence, between individuals and the national institutions. Attention should also be paid, however, to the mechanisms of horizontal confidence –i.e., between individuals–, especially in Latin America. In this region, as Roberto Da Matta emphasizes in his works, special importance is assumed not so much by the vertical confidence mechanisms as by those governing horizontal confidence: that is to say, inter-personal, informal relations rather than institutionalized or formalized relations (Da Matta, 1983).

Likewise, these generalizations should be self-subverted on the basis of comparative analyses between the different Latin American countries. The studies on mechanisms for the regulation of trade conflicts suggest that there are differences between countries like Argentina, where businessmen, like

²³ See Hirschman (1995b). In that essay he mentions Putnam (1993). This idea of conflicts as essential factors in socialization has also been developed by authors such as the early 20th century sociologist Georg Simmel, who was a contemporary of Max Weber, or the French philosopher Marcel Gauchet. See in this respect Simmel (1995) and Gauchet (1980).

²⁴ This theory was extensively analysed by Hirschman (1997) in one of his most interesting essays.

²⁵ See Knack and Keefer (1997), Alesina and Wacziarg (1998) and Helliwell and Putnam (1999).

²⁶ Although there is extensive sociological literature on coexistence, and especially on the sociological aspects of cafés, analyses in economic terms are much fewer, with the notable exception of those by some economists such as Tibor Scitovsky. In an admirable work, Scitovsky notes that in the so-called developed economies there is some degree of atrophy of social capital if we measure it as time capital: that is to say, activities involving the sharing of time. Time budget studies indicate that between 1934 and 1996 (the period covered by the data given by that author), the time devoted to meals in those countries went down considerably, from 107 to 70 minutes per day, while the time devoted to recreative strolls went down from 22 to 1 minute; Scitovsky also mentions in his study the frequency and length of Frenchmen's visits to cafés (see Scitovsky, 1976, especially pp. 161-163 and 241-245). These studies represent an invitation to make more detailed comparative studies, in terms of time budgeting, on the forms of cultural behaviour observed in Latin America and perhaps thereby confirm the idea that social capital, in the sense of "time capital", may be distributed better in more traditional societies where "holistic" activities predominate over "individualistic" ones. For an introduction to the economic analysis of the arts, see Throsby (1994), pp. 1-29.

those in Spain and France, prefer to settle their disputes out of court, and Colombia, where businessmen (as in the Scandinavian or English-speaking countries) prefer judicial settlements.²⁷ It is necessary –not only at the national but also at the local

level– to gain a better understanding of how the different rules of coexistence which regulate discord and concord and which help to create or destroy the famous “social capital” are linked up, assimilated and implemented.

VII

The economic, social and political virtues of banquets

Although economists are agreed on the importance of “civism”, “confidence” or respect for shared “ethical rules” in order for the economy to operate efficiently, it is not so easy to understand what actually takes place when these inputs are activated. The “learning by doing” model proposed by Hirschman and originally inspired by Arrow (1962) allows us to reconsider this aspect, with emphasis on the accumulative process that is set in motion when that very special resource or capability called “social capital” is activated.

Just like physical, economic, financial and also human capital, social capital can be created or destroyed, increased or diminished. All societies –both poor and rich, both those that lack efficient educational systems and those that do have them– possess this very special kind of capital which, unlike other forms of capital, increases with use and diminishes if not used. “Love”, “civism”, “confidence” or “ethical rules” are not limited resources and do not decrease with use, as also is the case of skills, which increase when they are used. “Love or civism” writes Hirschman “are not limited or fixed resources as other factors of production may be”, they are “resources whose availability, far from diminishing, increases with use” (Hirschman, 1986a).²⁸

A particularly interesting example of the foregoing is that of banquets, whose virtues are not only alimentary but also political and social, as Hirschman points out in an inspired article (Hirschman, 1997). Banquets allow him to self-subvert his idea of the clear and categorical difference between the public and private spheres, while at the same time highlighting the “virtuous” dynamic that they activate. Although traditionally considered as private acts, banquets have in fact played, and continue to play, an eminently public role. They represent notable social acts in which it is sometimes just as important to know who you are eating with as what you are eating. They create and recreate social capital and promote coexistence among their various participants; their virtues are not only “civilizing” –according to sociologists such as Simmel and Elias, among others– but also eminently political. The experience of sharing a meal is frequent, repeated and lasts a certain length of time, and it allows the participants to get used to seeing each other, talking to each other and gathering together around a table or a barbecue, indoors or out.

Such an experience is above all an action of time-sharing, a community action *par excellence*, whose external benefits would of themselves justify some form of subversion (like those justified by Scitovsky, as Hirschman recalls, for the benefit of the arts). Indeed, in Ancient Greece, as banquets were considered the maximum manifestation of social and public links, they were subsidized by wealthy families; eating together was considered an institution which brought out the continuing ex-

²⁷ With regard to the importance of legal systems for settling business conflicts, see the pioneering comparative studies by La Porta and López de Silanes (1998).

²⁸ Originally in French.

istence of political power in democracy. Likewise, in the early years of the French Republic banquets also had political functions and were seen as evidence of an ethic of coexistence which could help to consolidate a feeling of belonging and were occasions for learning in the political sphere.²⁹

Although the foregoing should not be taken as an invitation to subsidize banquets in order to create and recreate "social capital" (as Hirschman points out, there have also been banquets which were not virtuous at all, such as for example those held by the Nazis), it does prompt one final question: how can we ensure greater participation?

VIII

Social capital and participation.

A reinterpretation on the basis of Hirschman's triptych: exit, voice and loyalty

Finally, the following is an interpretative exercise based on the triptych prepared by Hirschman in the early 1970s in his famous essay *Exit, Voice and Loyalty: Responses to Decline in Firms, Organizations and States*. In that work, Hirschman seeks to understand how economic systems (firms) and political systems (states) deal with the defection of their clients or citizens. He seeks to do so on the basis of three possible responses by dissatisfied clients or citizens: exit (the client or citizen leaves, stops buying the product or ceases to participate in his national community of origin); voice (the client protests and expresses his dissatisfaction; the citizen engages in demonstrations or organizes a strike), or the client or citizen remains loyal in spite of everything (he sticks with the product or continues to function as a citizen).

This interpretative model has been widely used and re-used to explain not only economic but also political phenomena. For example, shareholders may very easily decide to get rid of their stocks on the stock exchange (exit), especially when they do not

have any influence on the running of the firm (corporate governance), that is to say, they have no possibility of raising their voice. The same interpretative model also makes it possible to explain the mechanisms whereby international financial crises spread, as we ourselves have suggested (Santiso, 1999). In the case of a married couple, when there are facilities for obtaining a divorce the propensity for expressing their feelings (voice) may be less, and fewer efforts will be made to communicate and to seek a reconciliation. On the basis of this triptych, Hirschman himself has given us an original interpretation of the fall of the Berlin Wall, which sparked off a massive exit from Communist systems in general (Hirschman, 1993).³⁰ In that same study he also took the opportunity to self-subvert his initial thesis, demonstrating in particular that in this case exit and voice are not strictly contradictory phenomena or mutually exclusive responses, but adaptive or reactive responses which can be combined or even strengthen each other.

This analytical scheme can also be applied to many of the problems that arise in the field of development. The dilemma is always the same: how to foster loyalty when, for example, trying to introduce participative models. One of the most important aspects is that of encouraging the beneficiaries to ex-

²⁹ With regard to Ancient Greece and French Republicanism, see Schmitt Pantel (1992) and Ihl (1996 and 1998). Not only is it important to know what one is eating, and with whom, but also how one is eating; the different forms of cuisine are characteristic of different types of societies, as the anthropologist Jack Goody pointed out in *Cooking, cuisine and class. A study in comparative sociology* (Goody, 1982).

³⁰ For other examples, see Hirschman, 1981a and 1986b.

press their views (voice), both in the formulation of participative programmes and in their implementation and evaluation. In this way it is possible to reduce the likelihood of exit, i.e., the likelihood of failure and defection. The key lies in creating a mechanism which makes it possible to strengthen loyalty and confidence and thus ensure more and better participation. As Hirschman says, fostering "voice" is not an easy matter: it usually costs more than exit in terms of time, effort and money. Only in configurations where there is a high level of loyalty can voice be less costly than exit, when the latter means giving up the essence of one's own identity. At all events, voice is preferable to exit, however. Favouring voice in participative programmes makes it possible, throughout the "three steps of the dance", to collect more information on the real needs of the beneficiaries of such programmes and to ensure better execution and evaluation of the programme by favouring immediate feedback.

This analytical scheme is particularly important for going more deeply into a problem currently encountered when dealing with development. In a globalized, interconnected world in which frontiers are much less clearly marked than before, differences in standards of living stand out even more vividly: even in the remotest villages in the Mayan reserve of Sian Ka'an, for example, the inhabitants are aware through some satellite that there is something more out there in the world. The satellite dishes are continually and insistently focussed on that "outer space". Although exit phenomena (migrations) were always important factors, nowadays the challenge of the brain drain is even greater. Latin America, for example, has gone from a situation where it was a recipient of immigrants to one where it is suffering from massive emigration, especially of its most highly qualified citizens. In other words, it is losing its most vital forces of human and social capital, especially in the case of Central America.

A recent study by the International Monetary Fund shows that emigrants from those countries to the United States tend to be more highly qualified than the national average of their countries of origin. Generally speaking, the rates of emigration of highly qualified inhabitants from the countries of Latin America and the Caribbean are high (generally over 10% and in some cases even over 50%). The country with the biggest brain drain is Guyana, where over 70% of the inhabitants with higher (tertiary) educa-

tion have gone to the United States. It is followed by Trinidad and Tobago (60%), El Salvador (26%), Panama (19.5%), Nicaragua (19%), Honduras (16%), the Dominican Republic (14%) and Guatemala (13.5%). Mexico and Colombia also register substantial rates (10.5% and 6%, respectively, in contrast with the rates for Argentina, Chile and Uruguay, which are 2%, 3.5% and 4% respectively (Carington and Detragiache, 1998).

In the field of education, as the last report by the Inter-American Development Bank shows, this Hirschmanian reading of the situation suggests that there are difficulties in terms of exit, voice and loyalty.³¹ The studies show that the high-income families avoid using public education. In these higher income groups, only 40% of their children, and in some countries as little as 25%, attend public schools. There are cases of forced withdrawal from school, such as those caused by financial crises or macroeconomic shocks, which lead to a serious loss of human capital by obliging young people to enter the labour market before their time (premature exit of students) or by causing the dismissal of workers and thus depriving firms of the capital represented by the workers' accumulated knowledge (exit from the labour market) (see Márquez, 1998).

Here, as in the examples given earlier, a central aspect is the need to give voice priority over exit. In the case of education, for example, greater rights could be given to beneficiaries in order to provide them with opportunities to make their voices heard and make known their dissatisfaction with the school system and the reasons for it. The school councils set up in El Salvador, Nicaragua, Brazil and Bolivia are an example of a possible response to this, as they ensure the participation of parents by giving them responsibilities that extend from the election of directors to the management of financial resources and participation in mechanisms for the evaluation of the teaching staff. Likewise, at the level of higher education, participative systems could be established for the involvement of students in the process, especially in the evaluation of professors and of proposed

³¹ The following examples are taken from the Inter-American Development Bank's 1998-1999 report on economic and social progress in Latin America (IDB, 1998, pp. 57, 109 and 142 *et seq.*).

study programmes, while taking a number of precautions to ensure that there is no involuntary self-subversion of the purpose of these evaluative mechanisms.

The analysis could be self-subverted by noting that in many cases the problem is not to prevent peo-

ple from leaving but rather to favour their entry. For example, measures could be taken to promote the incorporation of micro-entrepreneurs into credit markets (through micro-credit banks, among other initiatives) or to promote the entry of women into stable labour markets.

IX

Conclusion

"In dealing with the multiple and complex problems of development we have learnt that we must fashion generalizations at all kinds of ranges and be deaf, like Ulysses, to the seductive chant of the unique paradigm"

Albert Hirschman (1995a)

As we have tried to show here, Hirschman's works encourage us to review the road ahead and the paths already travelled in the light of practical experience. The distribution of income and wealth is very unequal in Latin America, as noted in the IDB report, which calls upon us to take advantage of the demographic opportunities existing today in order to speed up development.

The region's achievements in terms of structural change contrast sharply, however, with the uneven progress made in the solution of these distributional disparities. The structural reforms which have been made have succeeded in synchronizing the clocks of the Latin American countries with world time. Many inhabitants of the region, however, still lack the minimum instruments needed for taking advantage of that synchronization, in terms of education, health and income. The 1990s brought surprising structural achievements, with far-reaching reforms, but they were also years of brutal crises, with growth rates that did not benefit all sectors of the Latin American population alike. The most amazing feature has been the tolerant attitude of the sectors whose situation did not improve.

Perhaps this is yet another example of the tunnel effect, which we want to overcome. As long as people are in the tunnel of underdevelopment but have

some reason to hope that they may eventually emerge from it, because they know that some passengers have done so, moving up from economy to business class—in other words, as long as there are mechanisms for rising socially—the tunnel effect works and the capacity for tolerating inequality may be very great. That capacity for toleration may be eroded, however, if the end of the tunnel is never reached and there are no more cases of moving up from economy to business class. "As long as the tunnel effect lasts" writes Hirschman, "everybody thinks they are doing better, both those who have got rich and those who have not....But this tolerance is a loan which eventually expires. It is granted in the expectation that, with time, the disparities will grow smaller. But if this does not happen there will undoubtedly be problems and maybe even disaster" (Hirschman and Rothschild, 1973).

It may be that the tunnel effect is wearing off in Latin America. It may also be that this will not lead to disaster. Once again it will be necessary to invent and imagine forms of trespass and self-subversion and to keep on searching, with curiosity and humility, ignoring like Ulysses the sirens' insistent song. In order to do this, it will not be enough merely to put wax in our ears. Perhaps what we will really need is a bias for hope and a little more reverence for life.

(Original: Spanish)

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Prevention or repression?

The false dilemma of

citizen security

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There is a marked contrast between the growing sense of insecurity among the population and the absence of consolidated statistics that would allow the phenomenon to be measured more objectively. This article seeks to make a contribution to the knowledge of the situation of citizen insecurity affecting the region, taking a comparative view based on the limited and not always reliable information available and looking at the problem from various standpoints, both social and economic. The authors begin by examining some manifestations of criminal violence in the 1990s, especially in urban areas, after which they review the most important theories on the study of violence, the profiles of victims and attackers, traditional and emerging forms of delinquency, the frequent relation between violence and unemployment, the economic cost of violence and delinquency, and the main policies adopted to deal with them. They then go on to examine the measures taken in the region with regard to citizen security, which have shown the need to use more integral forms of prevention (primary and secondary) and control for dealing with criminal violence and to consolidate the systems of crime statistics of the region in order to be able to identify the factors with the greatest incidence on criminal violence and the less visible forms taken by the latter.

I

A diagnosis of citizen security and violence in Latin America

1. The relations between delinquency and violence. Concepts of citizen and public security

In social science there are two basic theories on the study of violence and criminal conduct, which are used in various combinations: the theory of forms of socialization and the theory of rupture or anomy. The first of these emphasizes socialization, as it holds that violence has organizational, institutional and cultural dimensions which can lead to the selection of violent strategies by certain social actors. Thus, the theory put forward by Sutherland claims that the primary causes of delinquency lie in the existence of subcultural groups of criminals (friends, family, prison acquaintances) which pass on criminal know-how (ILPES, 1997).

The second theory places more emphasis on the structural and social dimensions as explanatory factors: violence stems from the breakdown or maladjustment of the social order, that is to say, from rapid social changes due to industrialization and urbanization which dissolve the traditional social control mechanisms and generate a gap between aspirations and the socially and culturally accepted means of making them come true (Martínez, 1990). Thus, for example, Malton's theory holds that criminal conduct depends on the capacity of individuals to attain their goals in line with their social environment and the importance attached to economic success (ILPES, 1997). From this standpoint, then, there is an important correlation between poverty and delinquency and social exclusion.

Against a background of rapid changes in the economic field and the appearance of new economic needs, the deterioration in the quality of life of broad sectors of the population and the failure to solve long-standing problems (civil wars, inequality of income distribution and access to land), delinquency seems a self-defence mechanism for unlucky losers (traditional forms of delinquency such as burglary, theft or armed robbery) or as a new way of making

easy money through corruption or through new methods such as laundering hot money, electronic fraud, etc. (Moulian, 1997).

With regard to the definition of violence, there is some degree of consensus that it should be understood as the use or threat of physical or psychological force with harmful intent on a recurrent basis and as a way of settling conflicts (Guerrero, 1997; McAlister, 1998; Tironi and Weinstein, 1990). Violence is related to aggressiveness but is more than just an aggressive action, because it is recurrent and forms part of a process; it may also be noted that there are aggressive actions which are not violent. Aggressiveness has a psychological basis in frustration, but in order for frustration to give rise to aggressive actions it must be combined with other elements: for example, obstacles to the attainment of an anticipated objective, rage over arbitrary treatment, or a habit of responding aggressively to problem situations (Tironi and Weinstein, 1990). In other words, violence and related aspects such as aggression or frustration depend on a complex set of psychological, social and cultural elements.

In defining citizen security, emphasis has been placed on various dimensions and levels, especially its intangible and subjective nature. Broadly, it may be defined as concern for quality of life and human dignity in terms of freedom, access to the market and social opportunities. Poverty and lack of opportunities, unemployment, hunger, deterioration of the environment, political repression, violence, delinquency and drug addiction can all be threats to citizen security (ILPES, 1997, p. 5). From another standpoint, it is held that citizen security mainly means not living in fear of suffering a violent attack, knowing that one's physical integrity will be respected, and, above all, being able to enjoy the privacy of one's home without the fear of assault and moving freely around the streets without the fear of being robbed or attacked. Security would thus be a cultural construct involving an equalitarian form of sociability, an environment freely shared by all (UNDP, 1998, p. 128).

At a more limited level, public security has been defined as the set of coherent and interlinked policies and actions which serve to guarantee the public peace by the prevention and repression of delinquency and offences against public order through a system of penal and administrative control (González Ruiz, López and Núñez, 1994).

2. Factors associated with violence

The complexity of violence is reflected in the great variety of different types and levels it displays. By its nature, violence may be classified as physical, psychological or sexual; by its victims, as violence against children, women, or old people; by its motive, as political, racial, etc., and by its place of occurrence, as domestic, workplace, street violence, etc. (Guerrero, 1998; Larraín, Vega and Delgado, 1997). Violence can also be defined according to the effects it causes in its victims and may be cross-referenced as personal or institutional and physical or psychological violence.

In view of the nature of the phenomenon of violence, it is necessary to adopt a multi-causal approach—like the epidemiological approach used in public health—in which the aim is not to establish the cause of violence but to identify the factors that produce it or are most frequently associated with it (Guerrero, 1998; PAHO, 1996) and those that usually operate together, with emphasis on the work of prevention. In this approach, the causality is always interpreted as probability, so that the more factors of risk are present at the same time, the greater the probability that the phenomenon will occur (Fedesarrollo, 1996).

The factors of risk may be classified in three main groups:

i) factors related with the position and family and social status of the persons in question: sex, age, education, socialization in an atmosphere of violence, consumption of alcohol and drugs;

ii) social, economic and cultural factors: unemployment, poverty, overcrowding, social inequality, violence in the mass media, culture of violence, and

iii) contextual and institutional factors: war, drug trafficking, corruption, availability of firearms, parties and other festive occasions.

Quantitative information is available for some Latin American countries on some of the social and economic shortcomings usually associated with ur-

ban violence¹ (table 1). The interaction of these quantifiable factors of risk with others of a more qualitative nature on which information is not available can give rise to a climate of violence. The factors set forth in the table should also undoubtedly be related with others of a historical and cultural nature in order to understand the phenomena of urban violence and the differences between one country and another. Nevertheless, the quantification which has been made of some social and economic factors does indicate situations of risk that should be tackled with effective public policies.

3. Poverty, delinquency and urban violence

The growth of urban poverty in the last decade is usually seen as being associated with the increase in violence, delinquency and insecurity in the cities. Violence and insecurity do not depend only on poverty, however (box 1). Experience shows that, rather than poverty, it is inequality—together with other social, cultural and psychological factors—that generates more violence. This allows us to gain a fuller understanding of the phenomenon of delinquency, in both its traditional and emergent forms. Various studies carried out in Peru and Colombia have found no relation between poverty and violence: the poorest regions are not the most violent ones, nor is there a correlation between poverty and the number of murders (Fedesarrollo, 1996; Reyna and Toche, 1999).

The existence of networks of mutual relations and confidence in a community fosters much smoother and less violent forms of interaction, even in conditions of poverty. This “social capital” (Putnam, 1993) can make the difference between a poor community with low levels of violence and a community with a similar level of poverty but higher levels of violence. However, it has been pointed out that there is also a “perverse” form of social capital in which the networks, contacts and associations serve illegal activities (Rubio, 1998a).

A fairly widespread interpretation on the generation of violence is that poverty generates frustration, and this leads to radical or aggressive forms of conduct which, in turn, give rise to violent situations. Taking this point of view, the idea is that the crises in

¹ This information is taken from the *Social Panorama of Latin America, 1998* (ECLAC, 1999).

TABLE 1

Latin America: Presence of urban violence risk factors, 1997

Quantifiable risk factors	Countries with a high presence	Countries with a medium presence	Countries with a low presence
1. Urban income inequality (ratio of 10% richest to 40% poorest)	Ratio of over 11: Brazil, Colombia, Chile, Guatemala, Panama	Ratio of 8 to 11: Argentina, Bolivia, Honduras, Nicaragua, Paraguay, Dominican Republic and Venezuela	Ratio of up to 8: Costa Rica, Ecuador, El Salvador, Mexico and Uruguay
2. Poverty of urban households	40% or more of households: Bolivia, Ecuador, Guatemala, Haiti, Honduras, Nicaragua, Paraguay, Venezuela	Between 20% and 39% of households: Brazil, Colombia, El Salvador, Mexico, Panama, Peru, Dominican Republic	Less than 20% of households: Argentina, Chile, Costa Rica, Uruguay
3. Rate of open urban unemployment	Over 10%: Argentina, Colombia, Panama, Uruguay, Venezuela	Between 6% and 10%: Brazil, Chile, Costa Rica, Ecuador, Honduras, Paraguay, Peru	Less than 6%: Bolivia, Mexico
4. Percentage of urban young people between 13 and 17 who neither study nor work	Over 15%: Honduras, Uruguay	Between 8% and 15%: Argentina, Brazil, Colombia, Costa Rica, El Salvador, Mexico, Nicaragua, Panama, Paraguay, Venezuela	Less than 8%: Bolivia, Chile, Ecuador, Dominican Republic
5. Educational deficit (percentage of urban young people aged 14 or 15 who have not completed 6 years' schooling)	Over 20%: Brazil, Honduras	Between 10% and 20%: Colombia, Costa Rica, Ecuador, Mexico, Paraguay, Venezuela	Less than 10%: Argentina, Chile, Panama, Uruguay
6. Percentage of urban young people between 13 and 17 who work	Over 15%: Bolivia, Brazil, Ecuador, Honduras, Mexico, Paraguay	Between 5% and 15%: Argentina, Colombia, Costa Rica, Venezuela, Uruguay	Up to 5%: Chile, Panama

Source: Prepared by the authors on the basis of ECLAC (1999).

Box 1**POVERTY IS NOT THE ONLY CAUSE OF DELINQUENCY***If it were:*

- There would be more delinquency in the least developed countries, while the richest and most highly developed countries would necessarily be the safest.
- The worst security crises should occur during the most devastating economic crises, but this has not necessarily been the case.
- The areas of a country with the highest crime rates would be the most economically depressed areas, but this is not always so.
- Among delinquents detected, there should be many workers earning the minimum wage, unemployed, or people who have been looking for work for a long time.
- Crime rates should go down as the economy grows.
- The solution to delinquency would depend on economic policy and on the wealth distribution pattern.
- All poor people would be potential delinquents.

Source: Prepared on the basis of data from the Mexican Institute for the Study of Organized Crime, A.C. (IMECO, 1998).

the economies of the region mean that large numbers of persons remain outside the formal labour market and the resulting frustration drives them to aggressive forms of behaviour, which would explain the waves of violence breaking over the big cities of the region. However, this form of analysis (poverty-frustration-aggression) may be too superficial to account for the varied and changing situations of violence observed. Indeed, there is evidence both for and against this approach. A study made in Santiago, Chile, estimated that an increase of one percentage point in unemployment leads to 4% more offences against property, thefts and robberies (García, 1997). In the same country, however, it was found that there was a greater propensity to violence among those waiting to enter the labour force (jobless) or those already incorporated in it as wage earners than among those most marginalized from the labour market (Tironi, 1989). Attitudes of adaptation and resignation were observed among informal workers. It would seem, then, that aggression is not the only response to frustration, and that individuals who do react aggressively do so because they have learned to respond in this manner.

Even though poverty may not be the sole cause of delinquency, it is nevertheless associated with it, as are other factors such as inequality and social injustice. Many of those who blame poverty for delinquency base their views on the profile of delinquents arrested and punished, who are mostly males of a low socio-economic level. It must be borne in mind, however, that the percentage of arrests is only small compared with the total number of offences committed. There are a large number of unpunished offences, such as economic offences or cases of corruption, which are often difficult to prove, involve economically powerful groups, and are likely to be committed by persons of higher educational and economic status.

4. The measurement of offences and their economic cost

The measurement of violent offences is a difficult matter because of the variety of definitions and classifications used to record them in different countries, due to the differences in the levels and types of violence in Latin America. The concept of violence is usually limited to physical violence, in order to facilitate the use of traditional forms of data collection, such as records of injuries or deaths. Although it is

more difficult to assess the psychological or emotional damage caused, however, this may nevertheless have disabling and permanent consequences (Larraín, Vega and Delgado, 1997).

Most of the countries of the region do not have a nationwide institution responsible for collecting, processing and consolidating this type of statistics, which makes it more difficult to determine the size of the problem and to construct series which show the evolution of violence and citizen security. With regard to the recording of offences, there are three types of sources of information: i) police records, which register the complaints made and reflect the response of civil society to the offences in question (De Rementería, 1998); ii) judicial records, which register court cases, and iii) health records, which register deaths and injuries. No country of the region carries out ongoing public opinion surveys to assess the level and evolution of citizen security.

Moreover, the reliability of the statistics is affected by the under-recording of some offences, such as common violence and, above all, sexual and intra-family violence. This latter type of violence is on the increase in almost all the countries, assuredly because more official complaints are lodged now that this type of conduct is considered a criminal offence rather than a private matter.

Some countries –Colombia, Chile, El Salvador, Nicaragua, Venezuela, Peru and Brazil– have made improvements in the typification and definition of levels of violence, in the measurement of its economic cost, and in other forms of assessment of the phenomenon such as surveys among victims which make it possible to analyse the true rate of occurrence of violence.

Generally speaking, analyses of violence are based on the statistics of violent crimes, especially homicides, because of their serious nature and the fact that they tend to be recorded more carefully and reliably, thus permitting their comparison over time and between countries (Rubio, 1998b). For the purpose of comparisons in the region, the rate of homicides per 100,000 inhabitants was used, which shows that between the 1980s and the mid-1990s there was an increase in violence in the region. International comparisons made in the early 1990s put Latin America and the Caribbean among the most violent regions of the world, with average rates close to 20 homicides per 100,000 inhabitants (Guerrero, 1998). More recently, in 1995, a case study in six countries of the region (Brazil, Colombia, El Salvador,

Mexico, Peru and Venezuela) calculates the rate at 30 homicides per 100,000 inhabitants (Londoño, 1998).

Between the 1980s and the mid-1990s, homicide rates rose in all the subregions, as well as in Brazil and Mexico. The highest rates were registered in the Andean area, and the biggest increases were in Colombia, where violence is now the main cause of death. The lowest rates were in the Southern Cone countries and the English-speaking Caribbean. The tendency for homicide rates to affect men much more than women continued (Arriagada and Godoy, 1999).

The rates have not only increased but also display great differences between subregions, countries, and even between cities in the same country. Around 1995, there was a great contrast between El Salvador, which had the highest murder rate in the region (117 per 100,000 inhabitants), and Chile, which registered only 1.8 homicides per 100,000 inhabitants² (table 2). The situation in El Salvador is striking on account of its seriousness, although the figures must be viewed with some caution because in that country there is no governmental or non-governmental institution which systematically assembles the information on violence. The data obtained are from the Fiscalía General de la República and are the figures with the greatest coverage, but they do not agree with those from other sources.

In Colombia the relative figures for homicides around 1995 are lower than those for 1990 (table 2), but the number of offences has not gone down in absolute terms and the perception of insecurity among the population has been increasing (Trujillo and Badel, 1998). Homicidal violence in Colombia has become established as a routine and generalized form of violence among the population and reflects a country at war, since no present-day society displays such levels of violence in times of peace (Rubio, 1998b).

Although there are differences between and within countries,³ most of them register an increase

² In Chile, the figures of 3.0 homicides per 100,000 inhabitants in 1990 and 1.8 per 100,000 in 1996 correspond to the complaints in respect of homicides officially lodged with Carabineros; in 1990 the number of cases of homicide brought before the courts amounted to 9.1 per 100,000 inhabitants, and in 1996 to 8.2 per 100,000, while the number of arrests for this crime came to 6.7 per 100,000 inhabitants in 1990 and 4.9 per 100,000 in 1996 (Fundación Paz Ciudadana, 1998a). Whichever of these indicators is considered, however, the rates did go down between 1990 and 1996.

³ In Colombia in 1996 the rates were 208 in Medellín, 108 in Cali, 60 in Bogotá and 35 in Cartagena de Indias (Colombia, Centro de Referencia Nacional sobre Violencia, 1996).

TABLE 2

Latin America (13 countries): Homicide rates per 100,000 inhabitants, 1980, 1990 and 1995

Country	Around 1980	Around 1990	Around 1995 (last available figures)
El Salvador	...	138.2	117.0
Colombia	20.5	89.5	65.0
Honduras	...	...	40.0
Brazil	11.5	19.7	30.1
Mexico	18.2	17.8	19.5
Venezuela	11.7	15.2	22.0
Peru	2.4	11.5	10.3
Panama	2.1	10.9	...
Ecuador	6.4	10.3	...
Argentina	3.9	4.8	...
Costa Rica	5.7	4.1	...
Uruguay	2.6	4.4	...
Paraguay	5.1	4.0	...
Chile	2.6	3.0	1.8

Source: Ayres (1998); PAHO (1998); for Peru, INEI (1998); for Chile, Fundación Paz Ciudadana (1998a), IDB (1998).

in homicides. Between 1980 and 1990 the homicide rate went up in 9 out of 12 countries in region, and in three of them it went up by a factor of between four and six (Panama, Peru and Colombia). In the first half of the 1990s, this rate had gone down in El Salvador, Colombia, Chile and Peru but had gone up in Brazil, Mexico and Venezuela (table 2).

With regard to robbery and theft, the statistical information collected also displays great diversity between countries, especially in the case of different forms of robbery, where the rates per 100,000 inhabitants display extreme variability because of the different definitions of robbery and its various forms and the differing coverage of the statistical records.

Other forms of crime have also increased. It is estimated that annual kidnapping rates increased in the early 1990s by over one point per 100,000 inhabitants in three countries: Colombia, Mexico and Guatemala. In Colombia they came to 9.7 per 100,000 inhabitants (*Latin American Newsletter*, 1997), while in Guatemala, in spite of the obvious under-recording of statistics on violence, cases of kidnapping also increased, with 74.6% of the official complaints of this crime being concentrated in the department of Guatemala (Castellanos and Corrales (eds.), 1998).

Attempts were made in the 1990s to measure the economic costs of violence, although the varying definitions of "economic costs" and the fragility of the statistical base make international comparisons difficult (box 2). A comparative study made by the

Box 2

TYPOLOGY AND DIFFERENT DEFINITIONS OF THE ECONOMIC AND SOCIAL COSTS CAUSED BY VIOLENCE

The Inter-American Development Bank (IDB) distinguishes between:

- Direct costs: through the health system, the police, the criminal justice system, housing and social services.
- Indirect costs: higher morbidity, higher mortality due to homicides and suicides, abuse of alcohol and drugs, depressive disorders.
- Economic multiplier effects: macroeconomic impacts and impacts on the labour market and inter-generational productivity.
- Social multiplier effects: impact on inter-person relations and on the quality of life.

Trujillo and Badel also distinguish between direct and indirect costs:

- However, they define the indirect costs as the negative secondary effects produced by violence, including: losses of productivity; reduction or diversion of investment; faulty resource allocation and increased transaction costs (that is to say, what the IDB would classify under economic multiplier effects).

In macroeconomic terms, a distinction is drawn between:

- Gross costs: these correspond to the costs borne by the victim of an offence (for example, the ransom in kidnapping).
- Net costs: these are the macroeconomic costs. Thus, a robbery or kidnapping does not give rise to costs in macroeconomic terms: it is considered a transfer, since it neither adds value nor takes it away.

Source: IDB, 1998; Trujillo and Badel, 1998.

Inter-American Development Bank (IDB), using a common methodology, found that these costs were considerable: in 1995 they came to 24.9 percentage points of GDP in El Salvador, 24.7 points in Colombia, 11.8 in Venezuela, 10.5 in Brazil, 12.3 in Mexico and 5.1 in Peru (Londoño, 1998).

Violence causes heavy costs, affects the economic and social development of a country in many ways, and has negative effects on its physical capital (Guerrero, 1998). In Peru, it is estimated that the public infrastructure has suffered cumulative losses of US\$ 25 billion due to terrorism (Reyna and Toche, 1999). Case studies made in Chile and Nicaragua have estimated the cost of domestic violence to the economy at 2% of GDP in Santiago, Chile, and 1.6% of GDP in Managua, not counting the judicial and police costs (Morrison and Orlando, 1997). In Rio de Janeiro, the direct cost for attention to victims and the economic costs for premature death and incapacity in 1995 were estimated at some US\$ 916 million. Male victims accounted for 67.9% of the direct cost of attention, 82.6% of the cost for incapacity, and 94.9% of the economic cost for premature death (ISER, Rede de Centros de Pesquisa, 1998).

Furthermore, violence depletes human capital, causes a deterioration in people's health, and leads to absenteeism and labour incapacity of its victims, among other effects. In the same study on Chile and Nicaragua it is estimated that domestic violence has severe repercussions on women's income. In Santiago, Chile, woman who suffer severe physical violence earn only 39% as much as women who do not suffer this type of abuse, and in Managua they earn only 57% as much (Morrison and Orlando, 1997).

It has been shown that violence destroys social capital. A study in Jamaica concluded that one of the clearest impacts of violence was the social fragmentation of communities, which makes it hard for any community organization to work if it is not based on fear and coercion (Moser and Holland, 1997).

Violence also affects the capacity of governments to combat it. The increase in violent acts makes it necessary to spend resources on the fight against violence which could otherwise be used for development, and it also fosters corruption. Furthermore, the population begin to have resort to private security systems when they perceive that the State is

not effective in this respect, so that it gradually loses legitimacy and importance. Finally, there is general agreement on the negative effects of violence on growth and on efforts to reduce poverty in the region (Ayres, 1998).

To sum up, then, although the calculation of the economic and social effects of violence is often only partial, because of the lack of basic information to put it on a proper footing, the economic impact of the various forms of violence is only too clear, and this is a useful point with regard to policies and programmes aimed at reducing it.

5. The profile of victims and aggressors

Another aspect which needs to be taken into account is the gender element in violence (not only in domestic violence). Gender is seen to be a cultural factor which puts certain people at risk and gives others a predisposition to use violence. The main persons involved in homicides are men, especially young men, both as aggressors and as victims. In Latin America external causes account for 20.5% of the total number of years of life lost through death or disability due to all types of reasons in the case of men, and 8.1% in the case of women (PAHO/WHO, 1994). The differences by sex are considerable in the 15 to 44 age group, since external causes are responsible for 51.7% of the deaths of men but only 24.5% of those of women. Among men, the main external cause of death is homicide (PAHO, 1998).

Along with sex, age is also a very important factor in the profile of victims and aggressors. Of all the homicides reported in Latin America, 28.7% affect young people between 10 and 19 years of age (Guerrero, 1997). In Colombia, homicides mostly affect young men between 15 and 34—in 1996 65.2% of the total number of homicides corresponded to men in this age group—with 13 men being killed for every woman (Colombia, Centro de Referencia Nacional sobre Violencia, 1996). In Guatemala, juvenile gangs known as *maras* have appeared, which are organizations made up of young people of both sexes, including both minors and adults, which establish links of solidarity and identity among their members. The *maras* fight for control of territories which they consider to belong to them; it has been estimated that in 1997 they operated in twelve zones of Guatemala City, where they have been blamed for committing hold-ups on buses and other offences (Castellanos and Corrales, eds., 1998). In Chile, an

increase has been observed in the participation of young people under 18 in cases of robbery with violence, where their participation has risen from 21% in 1995 to 32% in 1997 (Fundación Paz Ciudadana, 1998a);⁴ similar features are displayed by the majority of those arrested for offences, who tend to be unmarried young men of a low economic and social level.

A study of crime statistics on drug offences between 1985 and 1994 concludes that young people represent a disproportionately high share of arrests but a disproportionately low share of prisoners held in jail for all types of serious offences (homicide, rape, robbery, theft and drugs). Between 1986 and 1993, for this set of offences, 35% of those arrested were under 19 but only 12% of those actually sent to prison were young people. This is held to show “the high vulnerability of young people just for being young, and the predisposition of the police to put the blame on them” (De Rementería, 1998, p. 114).

Along with the greater participation of young people in offences, there have also been changes in the profile of delinquents and their *modus operandi*. Police authorities in Chile note that in recent years there has been an increase in the percentage of offenders carrying arms (nearly 99%) and in the consumption of drugs among them (70% of all young offenders use drugs).⁵ Some studies note that there has been a change in the patterns of conduct of those found guilty of offences, as most of them are now addicted to alcohol and drugs and are therefore more likely to display violent attitudes than in the past (Cooper, 1994).

6. Domestic and intra-family violence

In the case of intra-family violence, which has gained greater recognition in the law in recent years,⁶ the main victims are women. A transcultural study

⁴ The last report of the Fundación Paz Ciudadana indicates that between 1995 and 1998 the participation of young people between 14 and 18 in cases of robbery with violence increased by 207% (*La Tercera*, 1999).

⁵ Interview with police captain Marcelo Cáceres and study by Fundación Paz Ciudadana, Adimark and Gendarmería referred to in the article “Por qué gana la delincuencia” (*Las Últimas Noticias*, 1998).

⁶ All the countries of the region have ratified the Inter-American Convention to Prevent, Punish and Eliminate Violence Against Women (Belén do Pará, 1994). Most of the countries have therefore modified their national legislation to include punishment for cases of intra-family violence (Arriagada, 1998).

covering 90 societies showed that those with high levels of violence were also those that had authoritarian rules in the household, where the man was the dominant actor and there was social acceptance of physical or psychological violence as a way of settling conflicts (Levinson, cited in IDB, 1998).

It is estimated that over half of Latin American women have been victims of aggression in their homes at some moment in their lives, 33% have been victims of sexual abuse between the age of 16 and 49, and 45% have suffered threats, insults or the destruction of personal possessions (United Nations, 1999).

As already noted, intra-family violence can be physical, psychological or sexual. Some studies also include indirect violence, such as forbidding the spouse to study or work, isolation or confinement in the home, or other forms of restriction of freedom.

Case studies and surveys carried out all over the region bear witness to the magnitude of the problem (table 3). The incidence of violence against women varies from 40% to 80%, depending on the city where the survey was carried out. It is hard to determine whether the upward trends in cases of domestic violence are due to greater frequency of this type of offence, to fuller recording of cases when the offence is made subject to punishment under the law, or to increases in the propensity to lodge official complaints. In view of the seriousness of this phenomenon, it is essential that surveys and studies should be carried out to provide fuller and more detailed country information that will give a better idea of its magnitude and tendencies.

Another form of intra-family violence which has become more visible and frequent is violence against children. It has been maintained that adolescents who have been the victims of violence in their childhood are more likely to become perpetrators of violence themselves in later life. In Brazil, abandoned children are at once the main victims and the main culprits of urban violence (McAlister, 1998). Ayres (1998) estimates that there are 6 million minors suffering ill-treatment in the region, and 80,000 die each year as a result of damage done to them by their parents, relatives or other persons. A study made by UNICEF in 1996 reveals that in São Paulo over 75% of all the sexual attacks against minors reported to SOS Niño were committed by family members (in the following order: legitimate father, brother, stepfather, uncle), and 8% of the victims suffered this type of violence before they were three years old.

Children have also been affected by the interne-cine conflicts that have taken place in some countries of the region. It is calculated that in Guatemala, between 100,000 and 250,000 children lost one or both of their parents due to the war (PAHO, 1996). In that country, a study carried out by the National Commission Against Child Ill-treatment on the basis of hospital data shed light on three dimensions of the phenomenon: physical ill-treatment, sexual abuse and abandonment. Around 60% of cases of ill-treatment and 55% of cases of abandonment affected boys, while 94% of the sexual abuse was against girls (Castellanos and Corrales, eds., 1998).

7. Equal access to public and private security

Violence and insecurity among the inhabitants of the big cities give rise to significant social and economic costs which are shared out unequally in society and are one of the main obstacles to the development of the region. It is estimated that Latin American residents purchase more than half of the insurance policies against kidnapping sold in the world (*Newsweek*, 1998). In Guatemala, for example, it is calculated that total private expenditure on security is at least 20% greater than the public security budget (Gutiérrez, 1998): there are some 200 private security firms, some of them established by former members of the army or police force, of which only 30 are officially registered (Castellanos and Corrales, eds., 1998). In São Paulo, there are three times as many private security guards as the number of government policemen (*Newsweek*, 1998).

In Santiago, Chile, there are clear differences between the rich and poor sectors of the city. Whereas the municipalities with the most resources can organize security plans in coordination with the police, and even make contributions in order to increase the number of policemen assigned to a sector, the poorer municipalities cannot do this. It is estimated that the poorest communes of Greater Santiago are below the mean vigilance level equivalent per 100,000 inhabitants,⁷ which introduces a factor of inequity into the way police resources are distributed to combat crime throughout the city (Silva, 1999). Shortage of resources makes it necessary to establish priorities: thus, the central government opts

⁷ The vigilance level equivalent is the supply of vigilance services per commune (Silva, 1999).

TABLE 3

Latin America: Incidence of domestic violence in the 1990s

Country	Incidence of domestic violence
<i>Argentina</i> Buenos Aires	1997. Complaints of domestic violence: 1,820 1998. 1,700 persons were attended in the Intra-Family Violence Unit, 70.5% of whom had been attacked by their spouse (Hospital Alvear) 1998. The Argentine Association for the Prevention of Family Violence attended 5,000 persons
<i>Bolivia</i>	1994. It was estimated that out of 20,000 cases of violence reported, 75% corresponded to domestic violence. Domestic violence mainly affects women between 17 and 36, while most of the victims of sexual assaults are adolescent
<i>Brazil</i> (States of Rio de Janeiro, São Paulo, and Rio Grande do Sul-Porto Alegre)	1998. Out of 98,039 cases, 61% corresponded to bodily harm, 2% to sexual offences and 37% to threats
<i>Colombia</i> Santafé de Bogotá	1996. Total number of complaints of marital violence: 10,725 women injured. Over 20% were victims of physical abuse, 10% of sexual abuse, and 34% of psychological abuse
<i>Costa Rica</i>	1994. Total number of women attended in the Women's Unit: 2,299 1995. Total number of women attended in the Women's Unit: 5,445
<i>Chile</i> Santiago	1997. 40.7% of women between 15 and 19 living with a man suffered psychological, physical and/or sexual violence 1998. Total number of complaints of attacks on women in the country: 39,394 1997. Total number of persons arrested for using violence against women in the country: 4,363 1998. Total number of complaints of intra-family violence dealt with in the country: 12,810
<i>Ecuador</i> Quito	1997. 60% of women were being or had been beaten by their husbands: 37.3% "often", 25% "sometimes" and 35.6% "rarely"
<i>Honduras</i>	1996. Number of complaints of domestic violence or sexual abuse between January and September: 3,070, i.e., 11 complaints per day
<i>Mexico</i> Mexico City and nine other cities Monterrey and Nueva León	1995. 74% of all persons ill-treated were women, of whom 68% were between 13 and 34 years of age. Only 20% of the victims made an official complaint to the authorities 1995-1996. According to a survey made in Monterrey and Nueva León, 46% of all women over 15 living with a man said they had suffered psychological, physical or sexual violence at the hands of their companion
<i>Nicaragua</i> Managua	1994. Number of female victims of violence attended in non-governmental centres: 3,138 1997: 52.6% of women between 15 and 19 who were living with a man were victims of psychological, physical and/or sexual violence; 28% of them suffered severe physical violence
<i>Peru</i> Lima	1996. Number of complaints to the Police Unit for Women: 5,512 1996. In a survey of women in the middle and low economic and social sectors, 88% reported they had suffered violence at the hands of their partner; 84% psychological violence, 31% physical violence, and 13% actual physical harm It is estimated that there are 25,000 rapes per year
<i>Dominican Republic</i>	1994. Of the police reports and cases published in the press between 1990 and 1994, 95% were for violence against women and minors, of which 67% corresponded to homicides, 25% to beatings and 12% to rape
<i>Uruguay</i> Montevideo and Canelones	1997. 47.3% of the households studied registered cases of violence: moderate psychological violence, 24.6%; purely psychological violence, 12%; purely sexual violence, 0.7%; moderate physical violence, 4.6%, and severe physical violence, 5.4%
<i>Venezuela</i>	1995. Data from the Bicameral Commission of Congress: 75,530 cases of sexual violence 1997. Data from the Policía Técnica Judicial: 7,426 sexual offences where women were the victims: rape, seduction, kidnapping or incest. Twelve women were raped every day

Source: United Nations Inter-Agency Campaign on Women's Rights in Latin America and the Caribbean; Duque (1998); Reyna and Toche (1999).

to defend certain urban sectors –usually the city centre and commercial and financial areas– at the expense of other sectors such as working-class areas. This situation means that often public security is left to the community itself.

Although organized community participation in the fight against violence can serve to strengthen the programmes applied by the local authorities, problems arise when such participation is seen as the only alternative because of the lack of police protection, and not a complement to it.

The access to private security –i.e., the capacity to hire alarm services and private guards– is also unequal: these goods and services are shared out unequally among the different social strata, thus widening the differences between them. Insecurity in the high-income sectors has led to changes in the urban configuration of the cities and has restricted neighbourhood sociability through such developments as the establishment of closed neighbourhoods and shopping centres (malls) and the increase in condominiums and private guards.

The sensation of greater vulnerability and lack of protection differs markedly in the different socio-economic sectors. Whereas in the lower-class sectors insecurity takes the form of fear of attacks on one's physical integrity, in the higher-income areas it takes the form of fear for one's property.⁸ In the more prosperous groups, the range of security services and products available to them often serves to complement the protection provided by the police; in the poorer sectors, the only option may be to organize vigilance groups and other more rudimentary systems of protection against hold-ups and other crimes (home-made alarm systems). In Guatemala, nearly 200,000 persons have formed vigilance organizations. A recent measurement of the degree of insecurity in the different communes of Santiago, Chile, found that the highest levels of fear were in the poorest communes,⁹ which fits in with the fact that these are the communes where there is the greatest lack of protection and police vigilance. Another survey made in January 1999 on the degree of security felt to exist in the neighbourhood found that although, overall, a large proportion (70%) of women said they felt safe in their neighbourhood, this proportion went

down to 66% among women between 34 and 45 and women from the sectors of lower socio-economic level (Grupo Iniciativa Mujer, 1999). However, a study made between 1996 and 1998 on offences against property in 17 Latin American countries reveals that the percentage of those interviewed who have been victims of such offences goes up in proportion to their socio-economic level and the size of the city where they live and recent growth in the urban population (Gaviria and Pagés, 1999).

Kidnapping for economic gain mainly affects the moneyed sectors of the population, and may even cause them to leave the country. In Guatemala, for example, at least five important families, totalling some 40 persons, all of which have suffered kidnapping or extortion, have left the country because of the State's inability to give them protection.

Private security measures have also been reflected in the proliferation of arms among the civilian population, with results contrary to those expected. Rather than reducing crime rates (robberies or homicides), this ready availability of arms can increase and aggravate the consequences of acts of social or domestic violence, since attempts at self-defence increase the risk that the victims may be killed.

In the face of these developments, the capacity of the police and judicial institutions to control and judge offences has been swamped, and there has been a growing tendency to take justice into one's own hands and privatize security. Fear, the lack of effective justice, and the increased violence of offenders have increased the perception of insecurity of Latin American citizens.

8. Traditional and emergent forms of violence and delinquency

The appearance of new forms of violence and delinquency in various countries of the region has been observed in a number of different ambits. Some analysts have described these new forms as a heterodox and contradictory mixture of two types of violence present all over the region: political violence (guerrilla movements, torture, disappearance of persons, repression) and traditional criminal violence. The symbiosis of the two gives rise to a form of social violence which, although not exclusively political, does have political effects, so that it cannot be viewed merely as breaking the law (Castañeda, 1998).

⁸ See ECLAC (1997), in the chapter entitled "Agenda social".

⁹ *El Mercurio* (1999): article based on a survey made by the Fundación Paz Ciudadana.

Various authorities and specialists have declared to the mass media that the new forms of violence are attributable to a change in delinquents' *modus operandi*. In Chile, the evolution of delinquents' actions in the 1990s reflects a process of organization and planning of their offences (learning how to obtain arms and/or vehicles, studying the routines of their possible victims, etc.), and they now operate more in groups and carry arms. For other specialists, in contrast, forms of action such as the intimidation and physical and psychological ill-treatment of their victims—together with the use of arms, narcotics or paralyzing gases and masks, which have become more common in recent years—may also be due to the imitation of crime movies (*La Epoca*, 1995).

In some Central American countries, demobilized soldiers who previously served in the army or the guerrilla have become a mass of unemployed who are familiar with the use of arms and military strategy and have an abundant supply of arms at their disposal. In many cases these unemployed persons have formed armed bands which, in the view of some specialists, are one of the main sources of armed crime in the region. In Guatemala it is estimated that there are some 600 organized criminal bands with a total of 20,000 members, mostly led by former army officers (Gutiérrez, 1998).

In other countries, the reform of the police forces has led to similar situations. In Argentina, Peru and Brazil these reforms have left a consider-

able number of former policemen unemployed, thus helping to develop a more sophisticated form of crime carried out by quasi-military bands. "This means an increase not only in the number of criminal actions but also in their planning, their level of violence, and the importance of their targets" (*El Mercurio*, 1998a). Many of these bands are responsible for the many cases of kidnapping which have taken place in the region. Experts note that this type of crime is common in Colombia, where kidnapping has taken on the nature of a well-organized industry; in Mexico, where it is connected with small organizations and drug trafficking; in Brazil, where it is connected with organized crime and difficulties in applying the law, and in Guatemala, where it is carried out by the numerous criminal bands mentioned earlier (*Qué Pasa*, 1998).

Even more disturbing because of the magnitude of the resources they divert and their international effects, however, are the emergent forms of international crime which have arisen thanks to the existence of open, globalized market economies. Among these emergent forms are the new forms of drug trafficking, illicit activities involving electronic fraud (basically through credit cards), and the traffic in persons, human organs and blood products, and nuclear weapons and materials (IMECO, 1998). It has been asserted that international criminal organizations have taken more advantage of technical progress than the institutions responsible for watching over citizen security.

II

Policies for generating greater citizen security

1. The limitations of conventional approaches centering on control and repression, and the emergence of more integral approaches

a) Conventional approaches

Many of the efforts made in the region to tackle delinquency and violence have approached the problem from a conventional standpoint based on the police-justice-prison model, which places emphasis on the adoption of policies to control and repress crime and criminal violence. Not enough attention has been given to preventive measures, whose results are slower but are usually more efficient than those

of corrective approaches in terms of cost and are more effective for securing lasting solutions.

The results of the conventional model, which is long on repression and short on prevention, have not been satisfactory. It has not been able to reduce crime—indeed, the rate of homicides has gone up in the region— or the growing sensation of insecurity among the inhabitants of the main cities, and the judicial, police and prison systems are faced with serious problems and shortcomings. The main criticisms of this approach are that it does not view violence as a social phenomenon involving various different factors and that it only seeks to act by repressing violent

individuals, without doing anything to influence the family and social environment.

b) More integral approaches

The unsatisfactory results obtained make it desirable to review the approach in question and the underlying conception of the phenomenon of violence and delinquency. There is evidence that this phenomenon is fundamentally something which is learned, through physical abuse or exposure to it during childhood or through the influence of the media, post-war environments and cultural values which accept or promote the solution of conflicts by violent means. This means that if indeed violence is the result of responses which have been learned rather than innate tendencies, then violent forms of conduct can be changed. This is very important for policy formulation.

Another aspect which has assumed increased importance is the interpretation of violence as a multidimensional phenomenon which must be tackled with integral strategies in order to influence the individual, family, social and cultural factors that generate it. In order to understand violence, then, we must eschew "purely symptomatic approaches and simple reactions and recognize it as a psycho-social, political and cultural phenomenon on which isolated measures can only have marginal effects" (Krauskopf, 1996).

In line with this attitude, the World Health Organization (WHO) and the Pan-American Health Organization (PAHO) have adopted an "epidemiological approach" for dealing with violence. The adoption of this approach in some Latin American cities has been reflected in the application of a group of measures:

i) integral measures focussed on the risk factors most often observed in cases of criminal violence;

ii) short-term police control measures to deal with specific phenomena, sometimes for a limited period of time, with reforms in the judicial, police and prison systems which call for political and social consensus;

iii) preventive measures accompanied by police follow-ups such as controls over carrying weapons and consuming alcohol and drugs;

iv) primary preventive measures aimed at changing the attitudes, standards and forms of social behaviour of the population in general, and

v) secondary preventive measures aimed at high-risk groups such as young men who have been witnesses or victims of violence when they were children.

c) Common criteria

From the set of actions in the field of citizen security which are being carried out in the region and are listed in a survey made by ECLAC,¹⁰ it may be gathered that there is growing recognition of the need to carry out multidimensional programmes combining both control and preventive measures. A number of these programmes share some common criteria which could help to make measures in this field more integral.

One of these criteria is inter-agency coordination, which seeks to give measures to reduce the number of offences and increase their rate of punishment the necessary simultaneity, even though they are adopted at different levels: the community, local governments, private and governmental bodies, the police, judicial and prison systems, educational and labour bodies, etc.

Another common criterion is that of citizen participation, which means involving the population more fully into the problem of security and the search for effective solutions, by promoting the creation of networks of relations and organizing the community itself (social capital) to improve the prevention and reporting of offences and even achieve some degree of control over them. It is also necessary to promote closer relations between the community and the police and State institutions, since greater confidence of the population in those institutions can be essential for improving the perception of security and heightening the legitimacy of the political, police and judicial system in the fight against crime. In order for citizen participation to make an effective contribution to the prevention of delinquency, it must not be promoted only among the poor or marginal sectors, as a way of making up for the lack of resources. Organization of the citizens can in no case replace the efforts that the central and local governments should make to tackle citizen insecurity, nor can it take the place of the resources that should be devoted to this task.

Finally, a third criterion found in various different programmes is the use of prevention through educational programmes which promote the peaceful

¹⁰ For the preparation of the chapter on citizen security in the *Social Panorama of Latin America 1998* (ECLAC, 1999) a small survey was made among governors and mayors of Latin American cities in order to determine the main security problems in their cities and the measures, programmes and policies being adopted to deal with them.

settlement of conflicts by strengthening forms of conduct based on dialogue, collaboration and understanding.

The following sections describe the main measures implemented in the field of prevention and control, together with some proposals for improving the recording of offences at the national and regional levels and details of some cases where satisfactory results have been obtained by combining control and preventive measures.

2. Preventive measures

Particularly important measures in this respect include educational programmes, organization of the community, control of trafficking in alcohol, drugs and arms, and measures to combat poverty and inequality.

a) Educational programmes

These programmes can help to forestall violence in various ways. Firstly, they can do so by reducing the drop-out rate in schools. A number of studies have identified a relation between low educational levels and violence,¹¹ with high rates of dropping out from school among those who have committed some kind of offence. This is so in the case of the majority of the young people who are members of the many gangs which are responsible for much of urban violence. It has been stated that dropping-out of the educational system by young people reflects a deterioration in the perception of the economic value of education, that is to say, in the economic viability of the educational system, and a failure of the type of education provided to adapt to the needs of young people and their motives for attending school. As a number of studies have shown, those motives may be quite different from those assumed as the basis for the educational system, and may consist of the desire to get away from the house without causing problems (especially in the case of girls), to meet new friends, or to gain access to social and sporting activities (Krauskopf, 1996).¹²

Secondly, they can educate people to prefer the peaceful settlement of conflicts. Since the social learning process—especially in childhood—has a vital influence on whether or not people later take violent attitudes, formal and informal educational programmes which develop the skills to settle conflicts peacefully can give very good results. In the medium and long term, they legitimize non-violent ways of dealing with problems more effectively than other methods and protect individuals from the danger of acting violently. Some educational campaigns along these lines have helped to focus public attention on problems such as intra-family violence. This is particularly interesting because of the incidence of experiences of this type on the adoption of violent attitudes to the settlement of conflicts in adult life, which is often due to the difficulty experienced in childhood in internalizing patterns of control and self-control which allow persons to handle their aggressive feelings.¹³

The Anti-Violence Seminars held in Santafé de Bogotá are campaigns designed to foster more constructive conduct models in man-woman and father-child relations, along with peaceful ways of settling conflicts in the home (Alcaldía Mayor de Santafé de Bogotá, 1997).

Outside Latin America, a very interesting example is that of the work done by the Peace Education Foundation (PEF), a non-profit-making organization which has been carrying out peace education programmes since 1980 in 20,000 schools in the United States and has now extended its activities to Canada and Jamaica. Starting from the assumption that boys and/or girls are not born with innate skills in the peaceful settlement of conflicts, the PEF promotes the development of skills which will lead children and adults to face problems in the home, school and community in a non-violent manner. For this purpose, it uses innovative action programmes which include mediation in conflicts between schoolmates or workmates (training peacemakers) and direct training of students, teachers and parents as monitors.¹⁴

¹³ The IDB has prepared a video on this subject, entitled *Battered lives, shattered hopes: when a man beats a woman*, which has been distributed throughout the region as an integral element in the IDB's campaign to generate an awareness of the importance of this matter (IDB, 1997).

¹⁴ Evaluations made in 1991 in Dade County, Florida, showed that 86% of the conflicts where mediation was used in school were successfully settled, while an evaluation made among 163 parents who attended a workshop showed that 79% had improved the way conflicts and feelings were treated in the home (*El Mercurio*, 1998b).

¹¹ In Lima, for example, a study carried out by the IDB showed that low educational levels of the men were a key variable among the factors leading to domestic violence.

¹² In this connection, it is worth noting the work done by *Hombres Unidos* in El Salvador or the group "Los Especiales" in Bogotá, which seek to bring juvenile gang members into the educational system by giving them special opportunities for attending school (Guerrero, 1997).

Box 3

ATTITUDES THAT SHOULD BE FOSTERED BY EDUCATION FOR PEACE

Seeking to make people feel responsible for their own actions

This helps to inhibit aggression, since when people act in a "faceless", anonymous manner they tend to act more aggressively because they feel less responsible and are less conscious of the prohibitions against destructive and aggressive actions

Seeking to punish unacceptable forms of conduct in a climate of affection

Severe punishment, whether in children or adults, usually secures submission, but rarely "sinks in". Parents who are accustomed to apply severe punishment usually have extremely aggressive children; in contrast, children who are punished by adults in the context of an affective relationship can experience a strengthening of their non-aggressive tendencies, since they usually comply with the adults' wishes even when the latter are not present.

Rewarding non-aggressive patterns of conduct

Efforts should be made to strengthen and reward constructive and non-aggressive patterns of conduct which will enable children to cope with situations of frustration. Although it is neither possible nor advisable to try to prevent children from experiencing frustration altogether, because a child who is prevented from experiencing frustration will suffer even more pain and confusion when he finally is faced with it, it is perfectly possible to train children to respond to frustrating situations in a constructive and satisfactory manner.

Offering non-aggressive models

The presence of persons who react to difficult situations without being aggressive can be an important check on aggressive forms of conduct.

Fostering empathy with others

Carrying out "empathy training activities", such as teaching children to put themselves in the other's place, to play differing roles in different situations, or to strengthen relations with friends can be very positive. Most people find it hard to voluntarily cause pain to another person, unless they can find some way of de-humanizing the situation.

Source: Aronson (1995).

Programmes of education for peace should seek to promote responsibility for one's actions; punishment of aggressive forms of conduct in a climate of affection; rewards for constructive and non-aggressive forms of conduct; non-aggressive models, and empathy with others (box 3).

b) Organization of the community

Organization of the community has become an essential resource for the implementation of more integral security models, the aim being to promote the formation of networks of relations and organizations within the community itself and to foster links between the community and the police and State institutions for tackling crime.

These types of committees have been organized in most of the cities covered by the ECLAC study: Neighbourhood Preventive Councils in Buenos Aires, Local Security Fronts in Bogotá, Citizens' Committees in Mexico City, Community Security Councils in São Paulo, Neighbourhood Committees in San José, Costa Rica, and proposals for the establishment of neighbourhood citizen security committees in Santiago, Chile.

Other ways of promoting community organization include: combination of police patrols with the training of promoters to inform the community about crime and the application of various forms of prevention at the community level (public security programme in Mexico City); increased use of com-

Box 4

COSTA RICA: SOME LESSONS THAT CAN BE DRAWN FROM THE CAMPAIGN FOR A LAW AGAINST VIOLENT TREATMENT OF WOMEN

Actions

- Organization of a collective initiative to promote wide support for the adoption of a law
- Preparation of a plan of work aimed at generating a process of discussion for preparing the draft, creating favourable conditions for its adoption, coordinating the efforts of different institutions, sensitizing public opinion, and strengthening the work of women and of the anti-violence movement
- Broad participation in the preparation of the draft, reflecting the views of the women affected
- Ongoing discussion of the content of the draft law and analysis of strategies for reaching political agreements
- Lobbying among members of Congress, taking due account of the procedures of the congress in question and the limited negotiating experience of women
- Establishment of a mechanism for coordination and follow-up of the fulfillment of the law once it is adopted

Main criteria applied

- To motivate the participation of women from different organizations and social sectors
- To foster involvement in political negotiation
- To adapt expectations in the face of adverse conditions
- To keep up collective coordination, with the will to persevere both in the negotiation and the subsequent follow-up

Source: Campaign for a Law Against Marital Violence, 1997.

munity alarms (Medellín, Colombia); coordination of neighbourhood councils, Mothers' Unions and youth and civic organizations (Santa Cruz, Bolivia), and coordination among the police, municipalities and neighbours (such as the door-to-door programme applied by the police in Santiago, Chile, and the VIVA community police programme in Rio de Janeiro).

Forms of organization for forestalling and punishing intra-family violence are worthy of special attention, since the mobilization of women, who are the main victims of this type of violence, has been a key element in securing the adoption of laws in this respect in various countries of the region (box 4) and the establishment of social support networks for victims, which have increased the number of official complaints lodged against cases of this type of violence (refuges for victims in Peru, and the Family Friend telephone programme in El Salvador, which alerts the relevant institutions about cases of violence). Programmes aimed at the main aggressors (predominantly men) have also been organized (Men Against Violence, in Nicaragua, and the Men's Collective for Equal Relations, A.C. in Mexico (Red de

Salud de las Mujeres Lationamericanas y del Caribe, 1996).

c) Control of the sale of alcohol, drug trafficking and carrying weapons

Alcohol and drugs are increasingly associated with acts of violence and crime. In Medellín, for example, many of the juvenile gangs were formed by drug traffickers for the transport of drugs and protection of transactions. The drug trade is also linked with the internationalization of criminal activities, through the increasingly frequent connections between local organizations and groups in other parts of the region and Europe. It is therefore urgently necessary to go beyond the eminently police-oriented treatment often given to the drug problem and strengthen preventive and rehabilitation activities at the same time that measures are taken to improve the institutional capability of the police and judicial system to control such traffic.

There are various preventive programmes against the consumption of alcohol and drugs, among them the Programme to Educate and Foster Rejection

of Drugs in Schools (PROERD) in São Paulo and the DESEPAZ programme in Colombia, which has given strategic support to the restrictions imposed by municipalities on the sale of alcohol after a certain time of night (for example, the so-called "carrot time" in Santafé de Bogotá).¹⁵

The incidence of the carrying of arms on the increase in the seriousness of acts of violence calls for action to avoid the proliferation of arms in society as a supposed means of self-defence, especially in countries such as El Salvador, Guatemala, Nicaragua and Colombia. Measures such as restrictions on the right to carry arms and programmes for exchanging arms for useful goods have secured reductions in homicide rates. In Santafé de Bogotá the restrictions on the carrying of arms applied in September and October 1997 reduced common homicides by 30% in September and 23.3% in October, compared with the same months in 1996 (Alcaldía Mayor de Santafé de Bogotá, 1997), while in Panama the "Guns for Food" programme has also had satisfactory results: the population gives up arms, without having to explain their origin or being investigated, and receives food vouchers in exchange.

d) Combating poverty and inequality

If violence is seen as the result of anomy or social breakdown, then in order for there to be citizen security it will be necessary to create the economic, political and social conditions that favour the development and social cohesion of a country (Piñeyro and Barajas, 1995). From this point of view, poverty—and especially relative poverty—becomes a problem of security, not because being poor automatically turns people into delinquents, but because poverty can produce social fragmentation and become an obstacle to development. This is how the problem has been understood by the authorities of a number of cities which have incorporated efforts to improve the living conditions of the poorest sectors among the measures to cope with the citizens' feeling of insecurity. In Rio de Janeiro, for example, there is the Favela/Barrio Popular programme, which seeks to improve the urbanization of the favelas as a way of integrating them into the city (De Cerqueira, 1995); in Managua measures have been taken to regularize

land ownership titles; in Santa Cruz (Bolivia) efforts are being made to improve the quality of education and health services, as well as access to them, and in Lima the authorities are carrying out a programme for the recovery of abandoned children (Jardineros) and a programme for bringing children to the Municipal Child Aid Complex (ECLAC, 1999).

The generation of employment is another measure worthy of consideration, especially for young people mixed up in violent actions. The rate of unemployment among young people accounts for over half of all unemployment in the urban areas of Latin America (ECLAC, 1999). In view of the importance of work as a means of social integration and as a life project for many young people,¹⁶ policies aimed at forestalling violence should seek to increase employment opportunities for large numbers of young people as a way of overcoming the hiatus between the provision of skills and capabilities by the State and the ability of young people to take advantage of them.

An interesting example in this respect is that of Cali (Colombia), where a Social Coexistence Pact was concluded, under the DESEPAZ programme, between army officers and young gang leaders. In this Pact the authorities undertook to provide supplies and technical training for the young people, as well as job opportunities and legal aid, while the young people undertook to give up the armed conflict, stop their illegal activities, and make dialogue a key strategy for settling conflicts.

Employment also has important effects for the victims of violence, as it can help to change the balance of power in relations, as in the case of domestic violence. A study made by the IDB in Nicaragua in 1997 revealed that 41% of women who were not in paid employment were victims of serious physical violence, whereas among those who worked outside the home and received an income the corresponding percentage was only 10% (IDB, 1997). Other studies have revealed that being a victim of this type of violence can reduce women's possibilities of obtaining paid employment and also reduce the income they receive (Morrison and Orlando, 1997). These data show the positive effect that incorporation in the labour force can have in reducing both domestic and non-domestic violence.

¹⁵ It is important to bear in mind that measures of this type must be in keeping with the particular situation in each country and not represent restrictions on civil liberties.

¹⁶ Krauskopf (1996) has suggested that for some young people work may be a more constructive and equalitarian means of establishing social relations than attending school.

3. Control measures

The main control measures applied in the region are in three fields: the police system, the judicial system and the prison system. The shortcomings observed in all these fields highlight the need to make reforms that will enable them to fulfill their purpose properly.

a) *Reforms in the police system*

The inefficiency of the police system in combating delinquency has clearly revealed the problems from which it suffers, such as its reactive and bureaucratic nature, the lack of professional excellence and equipment of its personnel, low wages, the multiplicity of functions that the police have to fulfill, and cases of corruption. A number of proposals have been put forward for dealing with these problems:

- i) formulating strategic plans to overcome the reactive nature of the system, so that it can be one jump ahead of events and can foresee possible situations;
- ii) raising the professional level of the police through general training programmes and training in specific techniques against such offences as kidnapping, drug trafficking and mugging;
- iii) reducing the many and varied functions of the police, giving priority to law enforcement functions rather than those of an administrative nature;
- iv) increasing the number of policemen;
- v) increasing the pay of the police in order to improve their professional level and remove the temptation to moonlight as private security guards, and
- vi) strengthening the work of police control bodies, bringing to judgment members of the police who engage in illicit activities and thoroughly investigating accusations of torture or unnecessary violence.

Among the measures which have been applied in the region are: strengthening of the police through programmes of education in human rights, in Colombia; programmes to increase efficiency and honesty in the Department of Public Prosecutions in Mexico City; requirement of full secondary education for entering the police force, and an increase in activities to check police corruption, in São Paulo (ECLAC, 1999), and the plan applied by the Chilean police force involving the retraining of administrative personnel to carry out normal police duties, investment in logistical support, preparation of management indicators, and incorporation of new techniques such as computerized maps of crime locations.

b) *Reforms in the judicial system*

A number of countries in the region have embarked on programmes to reform the judicial system in order to strengthen its capacity to control and punish offences, reduce the level of impunity, and give the population a feeling of greater security and more confidence in the existing institutions. Some of these reforms are aimed at:

- i) improving coordination between the judicial and police systems;
- ii) allocation of greater resources to make it possible to investigate more offences, introduce new information systems, and raise the professional level of the staff;
- iii) better adaptation of the sentences applied in order to overcome the problem of disproportionate punishment (for example, avoiding cases where offences of different levels of gravity are given the same punishment) and to ensure that the sentences are actually carried out;
- iv) improving the treatment of victims: a more professional approach in dealing with reports of offences can help to shed light on the motives behind offences and to improve the way the information is recorded.

Latterly, alternative ways of applying justice have been developed which can provide a more expedite and timely way of settling cases of minor offences. Examples of such new methods are programmes to bring justice closer to the population, based on the peaceful settlement of conflicts, such as the Conciliation and Mediation Centres and the Family Precincts, both introduced in Colombia.¹⁷

c) *Reforms in the prison system*

There are some serious shortcomings in the region's prison system which have given rise to serious problems. They include the extreme overcrowding in prisons, which prevents the necessary segregation of prisoners accused of minor offences from those guilty of serious crimes, the high percentage of prisoners who have not yet been sentenced – 70%, according to International Prison Watch (1995) – and the serious shortcomings in the work of rehabilitation. These situations tend to distort the functions that prisons should play, which should be to punish

¹⁷ Around 1997, Santafé de Bogotá had 33 Conciliation and Mediation Centres (IPC, 1997; Alcaldía Mayor de Santafé de Bogotá, 1997).

according to the crime committed and to rehabilitate their inmates.¹⁸

Some of the measures proposed for dealing with these problems are:

i) the effective application in prison systems of the various international instruments on detainees which the countries have signed or ratified;

ii) the effective allocation in national budgets of the resources needed to improve the material conditions of the prisons of the region;

iii) more expedite trials and the elimination of the biases in the administration of justice which unjustly favour some prisoners (such as important drug dealers) and prejudice the rights of others (such as poor people, children and young people);

iv) measures to combat corruption and impunity not only in the case of criminals but also, when necessary, of guards and gang bosses inside the prisons, in order to put an end to the trafficking of drugs and arms and the many other abuses;

v) better use of the time that prisoners are confined for their rehabilitation, with special emphasis on educational, vocational training and psychological support, which have made it possible in other parts of the world to reduce the rate of recidivation;¹⁹

vi) the promotion of alternative systems of punishment without deprivation of liberty, since the authoritarian and oppressive environment of many prisons, together with the severe and restrictive punishments, can foster aggression (Aronson, 1995): it is therefore important to offer those who have committed only minor offences some type of alternative to imprisonment, subject of course to the necessary systems of supervision and control.

4. Preparation and improvement of systems of crime statistics

One of the most keenly felt needs when dealing with criminal violence and citizen security is the ability to gain a proper idea of the size and nature of the phenomenon in the region. It is therefore essential to improve the existing systems of statistics and work on

the development of an integrated system which will make it possible to follow up trends and make international comparisons.

Having this type of information available is vital for making diagnoses of crime, formulating policies and programmes in line with actual conditions, and evaluating the action taken.

Some initiatives have been taken in Colombia in this respect, such as the system of recording offences using an epidemiological approach under the DESEPAZ programme²⁰ and the proposal to set up local crime watch bodies as part of the national strategy in support of Peaceful Coexistence and Citizen Security, which should provide the basic inputs for the design, execution and evaluation of anti-crime policies by the authorities (Salazar and Castro, 1998).

In Chile, a joint programme between the government and a private organization has designed a Unified System of Crime Statistics (SUED, in Spanish) which integrates the information produced and collected at the police, judicial and prison levels, applying rules to make it internationally comparable. Computerized crime occurrence maps have also begun to be prepared at the commune level in order to permit the spatial identification of the most conflictive areas (Chile, SUED, 1997).

5. Combining preventive and control measures

Before looking at some examples of programmes which combine both these types of measures, we will summarize the preventive and control measures described earlier (box 5).

In order to achieve an effective combination of preventive and control actions to reduce criminal violence, three Colombian cities (Santafé de Bogotá, Medellín and Cali) have developed multidimensional citizen security programmes (DESEPAZ) which tackle the problem of civil insecurity on three fronts: enforcement of the law, education for peace, and construction of community institutions to foster peaceful coexistence.

¹⁸ Another problem which has been mentioned is that of the continued presence of some prisoners in jail even after they have completed their sentence, because of the lack of suitable institutions for receiving them. This is the case, for example, with prisoners suffering from psychiatric problems.

¹⁹ The Fundación Paz Ciudadana estimates that in Chile the recidivation rate is close to 55%.

²⁰ This system registers the time and date of the offence, the identity of the victim and culprit, the level of alcohol, sex and age of victim and culprit, the causes of the offence, the place of occurrence, and the address of the victim.

Box 5

MEASURES FOR GENERATING GREATER CITIZEN SECURITY

Preventive measures

Educational programmes

Reduction of school dropout rate

Education for the peaceful settlement of conflicts

*Organization of the community**Control of the sale of alcohol, drug trafficking and the carrying of arms*

Control measures

Reforms in the police system

Establishment of strategic plans

Raising the professional level of the police

Reducing the police's functions

Increasing the number of policemen

Raising police pay

Strengthening the control mechanisms for the police system

Reforms in the judicial system

Coordination between the judicial and police systems

Allocation of greater resources

Ensuring punishment is proportional to the crime

Improving treatment of victims

Reforms in the prison system

Application of the relevant international instruments in prison systems

Proper and effective budgetary allocation

Measures to expedite trials and eliminate biases in the administration of justice

Measures to stamp out corruption and impunity

Better use of the time during which offenders are deprived of their liberty

Promotion of systems of alternative penalties not involving deprivation of liberty

In Santafé de Bogotá, a security programme was established in 1994 based on measures to strengthen peaceful coexistence and negotiated solutions to conflicts through, for example, "healthy policies" to tackle the problem of citizen insecurity (box 6).

In Medellín, the Mayor's office has implemented programmes to help children and young people of poor communities who are in conflict situations, through the education, recreation and resocialization of young people, community participation, and use of the influence of the mass media to prevent violence and improve relations between the police and the community.

The measures taken in these three Colombian cities have indeed helped to reduce urban violence. Homicides in the three cities have gone down steadily in recent years. Thus, for example, in 1994 Santafé de Bogotá registered 3,885 homicides, but this figure went down to 3,531 in 1996 and 2,813 in 1997: a reduction of 27%. Similar results were obtained in Cali and Medellín, with the total number of

homicides (in absolute figures) going down by 27% in Cali and 35% in Medellín over the same period. This reduction contrasts sharply with the national average, which went down by only 5%, and with the average for the other large cities of the country, where the total number of homicides went up by 3% (Salazar and Castro, 1998).

In view of the results of these programmes and other specific actions, the Colombian National Planning Department and the IDB formulated a national strategy in support of Peaceful Coexistence and Citizen Security which will seek to unify initiatives at the local and central level designed to forestall and control factors which have been identified as being related with crime and violence. The measures envisaged include the creation of data bases and information systems, action to bring the judicial services closer to the community, education for peace and peaceful coexistence, the strengthening of the National Police Force and its relations with the community, programmes for young offenders, and community participation programmes.

Box 6

SANTAFE DE BOGOTA: POLICIES TO FOSTER IMPROVED SECURITY AND COEXISTENCE

<i>Objective</i>	<i>Actions to deal with violence and promote improved coexistence</i>	<i>Measures to promote improved coexistence</i>
Strengthening of institutions	Restructuring of Ministry of the Interior Strengthening of the police Training of police officers Bulletin giving statistics on violence and delinquency	New integrated management of security and social coexistence A properly trained police force with adequate manpower Timely statistical information on violence and delinquency made available to the authorities and the public at large, in order to evaluate the measures taken
Establishment of mechanisms to prevent and reduce the number of homicides	Control of arms by the police Suspension of permits to carry arms Discouragement of liquor consumption Police controls	Voluntary surrender of arms Campaigns to foster disarmament Restriction on opening hours of night clubs and bars and increase in breathalyzer tests. "Hand over your car keys" campaign against drunken driving
Development of accident prevention mechanisms	New traffic police	Discouragement of liquor consumption and increased use of breathalyzer tests Restriction on opening hours of night clubs and bars "Hand over your car keys" campaign against drunken driving Restriction of use of gunpowder in festivities Use of safety helmet by motorcyclists
Development of alternative methods for settling conflicts	Conciliation centres Family Precincts Police inspections	Campaigns against violence Programme against child abuse Campaigns in favour of more courteous attitudes
Greater community participation in security	Police strategies to promote and support community participation in security	Security campaigns Security training
Improvement of the prison system	Reconstruction and adaptation of the district jail Design and implementation of training programmes Design of a new project for the construction of a new jail	Improved processes for the social rehabilitation of prisoners Design of alternative models for the punishment and social rehabilitation of offenders

Source: Alcaldía Mayor de Santafé de Bogotá (1997).

Box 7

WORLD BANK: PROPOSAL FOR A COMBINED APPROACH

Highly effective forms of intervention

Epidemiological-type monitoring
Control of sale and consumption of liquor and of mental ill-health
Arms control
Effective treatment of urgent cases

Favourable macrosocial contexts

Abundant high-quality education
Equitable growth to reduce poverty

Integrated approaches which could give enormous benefits

Measures against impunity: increase the net expected penalty
Strengthening of independent public control (of the police force, the intelligence services and the judiciary)
More flexible preventive and non-public control measures
Beyond the schools: measures to strengthen the fabric of society and social capital

Source: Londoño (1998).

It is important to draw a distinction between programmes in different countries of the region which combine preventive and control measures, on the one hand and, on the other hand, programmes which do provide for combined action but give preference to repression and control measures.

An example of the latter type of programme is the "Zero Tolerance" plan applied in New York, which has been praised for significantly reducing crime in that city. Based on the "broken window theory" developed in 1982 as a result of the investigations of a group of United States criminalists,²¹ this Plan is based on the idea that every unpunished offence, no matter how small it is, represents an encouragement to commit more serious crimes, because delinquents get the idea that they will not be punished. In line with this approach, every kind of offence is now pursued (as the name of the plan implies), and police reforms have been made to increase the number of policemen, expand the pow-

ers of the police to arrest suspects and make searches, and apply a new approach to the fulfillment of targets designed to prevent crime rather than merely reacting to it. It is these measures which have been given priority—at the expense of social initiatives aimed at involving the community and forestalling crime, such as increasing the number of parks and sports facilities and establishing special schools for the rehabilitation of juvenile delinquents—and which have given rise to criticism on account of the police abuses they have sometimes permitted.

Some multilateral organizations, assembling examples from inside and outside the region, have identified forms of action which could be considered more effective in dealing with violence. The World Bank, for example, has made an evaluation of the problem and proposed some effective measures for dealing with violence using a classic epidemiological approach (box 7).

²¹ This group, headed by James Q. Wilson and George Kelling, made the following experiment: they left a car abandoned in a sleazy neighbourhood to see what happened to it and how soon. The days passed, but nobody went near it. Then they left a car which had a broken window. In no time there was nothing left of the vehicle.

III

Conclusions

As we have maintained throughout this article, violence and delinquency are multi-dimensional phenomena and are closely associated with subjective attitudes. Thus, efforts to explain them involve factors connected with the social and family position and situation of the persons in question, social, economic and cultural dimensions, and factors of a contextual and institutional nature.

One of the most obvious situations with regard to criminal violence in Latin America is the striking contrast between the growing sense of insecurity of the population and the absence of consolidated statistics which could give a more objective idea of the true magnitude of the phenomenon. Although the perception held by the population is undoubtedly an important element, the lack of ongoing statistics makes it difficult to prepare diagnoses that can serve as an effective guide for the measures that need to be taken by the public authorities, the private sector and the population at large.

Bearing in mind this lack, this article aims to make a contribution to the knowledge of the situation of citizen insecurity affecting the region by making a comparative analysis, on the basis of the limited and not always reliable information available and from different standpoints, both social and economic.

Our analysis has been centered on certain forms of criminal violence in the 1990s, especially in the cities, and is accompanied by a review of the most important theories for the study of violence, the profiles of victims and aggressors, traditional and emergent forms of delinquency, and the frequent relation that exists between violence and unemployment. Information has also been collected on the economic cost of violence and delinquency and the different policies adopted to deal with them.

We have emphasized the need to approach criminal violence from an epidemiological standpoint which takes account of the multidimensional nature of the phenomenon, and we have also tried to identify the factors which do most to favour violence in the countries of the region.

From this angle, we have examined the measures taken in the region in the field of citizen security, in order to identify the main trends and the most successful examples of action. It may be noted in this respect that in Latin America, as well as in other parts of the world, it has been becoming increasingly clear that more integral approaches should be adopted, combining prevention (both primary and secondary) with control when dealing with criminal violence.

The adoption of multidimensional programmes raises great challenges. As well as dealing with the most urgent needs, these programmes must also pursue solutions sustainable in the long term which effectively reduce levels of violence. Furthermore, in many cases it is also necessary to restore the confidence of society at large in the police, as a prior step to promoting community participation in and commitment to citizen security plans; to set about judicial and penal reform programmes, which call for major political and social consensuses, and to promote a long-term cultural change involving a move towards the peaceful settlement of conflicts in all the different segments of society.

The challenge also includes the consolidation of systems of crime statistics in the region in order to identify the most important factors affecting criminal violence and the more underhand and emergent forms that it takes.

(Original: Spanish)

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How domestic violence *came to be viewed as a* public issue and *policy object*

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This article analyses the process whereby domestic violence in Chile became a subject of open discussion and a public issue included in the institutional agenda of the Executive and the Legislature, giving rise to preventive programmes against such violence and public services for aiding its victims, together with the adoption of a law against intra-family violence in 1994. The analysis highlights the dynamic and complex nature of the process, whose course and results were not and could not be determined *a priori*. Public issues do not exist in their own right, as purely objective phenomena, but are constructed by actors who operate in different settings, exchanging and confronting discourses based on various frames of interpretation. Several different phases may be distinguished in the process, depending on the features and opportunities offered by the political and institutional system, the different types of actors involved, their organizational resources, the structure of the links they establish with each other, and the frame of interpretation that guides what the actors do. Seen from this standpoint, the emergence of cases of violence as a public issue is at the same time the story of the establishment of women as valid social subjects, their organizations, their strategies for mobilizing the issue in different public contexts, and the spread of new types of discourse and proposals on gender-related matters.

I

How public issues are constructed

The construction of public issues is supported and mobilized by different actors who join together around a matter which becomes the centre of their attention, initiatives and discussions and thus turns into an issue in the political domain. The actors recognize each other as being committed to the formulation, defence, negotiation and agreement on a solution for that issue. They enter, leave or remain in place, or change their roles and positions in the course of the process, which extends across various different social and institutional areas.

In an ideal cycle, a policy begins with the recognition of a given experience as a formal issue and problem by different actors who consider it unacceptable. The next step is the formulation of the problem as a public issue, for which it is necessary to define it, to formulate hypotheses on its causes, and to propose possible solutions. The cycle continues with the incorporation of the problem on institutional agendas.¹

The inclusion of the issue on the institutional agenda makes it necessary to translate it into the corresponding political and institutional logical frameworks before it can give rise to legal instruments, programmes or public services. As Muller and Surel (1998, p. 57) rightly note, "social phenomena pass through a series of prisms which act as selection mechanisms and modify the nature, audience and significance of the perceived phenomena in order to make them a legitimate subject of public action".

According to McAdam, McCarthy and Zald (eds., 1996), social movements are conditioned by the simultaneous influence of the opportunities of-

fered by the institutional and political system, the organizational resources and collective dynamics of the actors involved, and the different frames of interpretation that guide their behaviour. These factors interact and mutually strengthen each other, thus facilitating the emergence and subsequent course of social processes.

According to those authors, the opportunities for collective action, like its extent and the form it takes, are structured by the political system. At the same time, formal or informal organizational structures also have a fundamental influence on the extent and form of exchanges of views and discussions among the actors and on the actions the latter take to further the matters that interest them.

The combination of these two dimensions –political opportunities and organizational structures– provides a structural base for action. However, this base will not be enough unless it is accompanied by deliberate strategic efforts to construct a new shared view of the world, imbued with the conviction that the problem in question can be solved if all those concerned act together. This is how collective action on an experience or social situation considered to be unacceptable is legitimized and motivated.

The new frames of interpretation represented a break with those which sought to explain the situation in the past. In order for them to be accepted, they based themselves both on the existing principles and social values and on more abstract ones. As we shall see below, the interpretation of violence against women as an expression of their lower status in relations between the sexes called for a new frame of interpretation making explicit mention of sex discrimination. The acceptance of domestic violence as a public issue, however, stems from a prior consensus asserting respect for physical integrity and human dignity.

As may readily be supposed, the different interpretative schemes are neither permanent nor based on general agreement: they compete with each other, support or promote conflicts between the actors in a public domain, confirm or challenge the dominant interpretations and suggest alternative courses of action.

□ This article is based on the results of the study "The role of social networks in putting domestic violence on the public and institutional agenda" carried out in 1997-1998 by Virginia Guzmán, Kathya Araujo, Amalia Mauro, Vicente Espinoza and Eugenia Hola with the support of the Gender Studies Research Fund of the National Council for Science and Technology (CONICYT).

¹ The implementation of the corresponding law and of the necessary services and departments gives rise to a new stage in which the actors are mainly of an institutional nature and the characteristics of the relations involved are changed.

Three phases may be identified in the construction of the issue of domestic violence as a matter for public policy in Chile. The first is the emergence of the process when the country was still under a dictatorship. The second is the formation of the issue by actors coming mainly from civil society. The third is the institutionalization of the question of violence as a matter for State policy, in a different political setting marked by the restoration of democracy and more active and committed participation by democratic governments in international conferences.

In the first phase, suitable conditions were generated for women to meet in homogeneous groups in which they could share and reinterpret experiences of great significance for their lives, against a social

background which made people very sensitive to violence. In the second phase, cases of violence against women, especially domestic violence, were collected as a formal issue, while at the same time the social actors who would promote the matter and the organizations which would give it support and social strength were identified and established. In the third phase, the problem of domestic violence was decisively incorporated as a matter of public discussion and its institutionalization as a formal subject of public policy was begun. Intra-family violence – the new way of viewing domestic violence – goes beyond the social domain established in the previous phase and incorporates new institutional and political actors, thereby altering the positions and functions of the old ones.

II

The emergence of the process

As Pakman (1995, p. 296) rightly notes, social and cultural movements usually start with a more or less formalized set of conversations and social practices. "They do not usually start one fine day with a ritual declaratory founding event. Conversations and practices which are more or less devoid of any order, in areas which are not necessarily univocal and may sometimes even be contradictory, begin to produce forms of language capable of reflecting some particular area of human activities. At some moment, as a result of those processes and as part of the conversations, a reflexive action takes place through which these human groups see themselves reflected, define a field of interests, formalize their concerns and practices, forms of language and strategies, draw a border or frontier around themselves, set themselves objectives, share out functions and, ultimately, establish themselves as persons different from others".

The conditions conducive to the emergence of domestic violence as a public issue have been growing up gradually since the late 1970s.

In the first few years of the military regime most of the population came face to face with violence in its various forms: violation of the physical integrity of persons, persecution, authoritarian attitudes, arbitrary actions, unemployment or poverty, and loss of social reference spaces. As in the case of women the

repression took on clear sexual connotations, the population became more sensitive to women's vulnerability to sexual abuse.

The restriction of individual and collective liberties, together with the closure of spaces which had existed earlier – political parties, trade unions, neighbourhood associations – gave rise to a generalized climate of fear and inhibition which impeded the collective expression of the social trauma represented by the military coup.

At the end of the 1970s the indiscriminate repression applied up to then was slightly relaxed, and the Vicariate for Solidarity and the Academy of Christian Humanism² stimulated the formation of

² The Academy of Christian Humanism was founded in November 1975 by the then Archbishop of Santiago, Cardinal Raúl Silva Henríquez, as "a response to the particularly difficult situation in which the Chilean intellectual community has found itself since the installation of the military regime in the country". This situation had led to the intervention of the universities by the new regime, involving the expulsion of thousands of professors, students and administrative personnel, the elimination of courses, changes in curricula, and limitations on research, teaching and extension activities. The Academy welcomes these professionals in its different Research Programmes and in its eleven Study Circles, among which is the Study Circle on the Status of Women (Academy of Christian Humanism, undated).

new social organizations, circles of professionals and collectives for the defence of human rights which welcomed and facilitated the meeting of persons from the former social and popular organizations, political party militants, trade unionists and professionals.

Human rights organizations, people's organizations and non-governmental organizations (NGOs), which became increasingly numerous in the 1980s, became the spearheads for efforts to reconstruct the social fabric. In this task they received aid in the form of international cooperation for supporting the efforts being made in Chile to rebuild the social links that had been destroyed by the dictatorship.

The energy that had been blocked by violence and repression was restored in these areas thanks to the affective and emotional nature of the links that people generate within themselves, and it served to promote the collective expression of the traumatic experiences suffered and to foster action aimed at surviving and resisting the military regime.

The Vicariate for Solidarity stimulated the organization of soup kitchens, production groups and other collectives which were mainly made up of women, partly because women were seen as being more neutral as far as the political struggle was concerned and less closely involved in the confrontation that preceded the military coup. These organizations were imbued with the characteristics of the personal experiences of these women and were more flexibly adapted to their everyday rates of activity and responsibilities. In them, the women discussed questions relating not only to repression and political violence, but also to their everyday life. This set in motion the emergence into broad daylight of the different types of violence suffered by them, including violence inflicted on them by their spouses.

In these first moments, it was accepted that the political violence used against women had clear sexual overtones, and in these new organizations women talked about their experiences of domestic violence. However, they were far from interpreting the different forms of violence suffered by them as expressions of a single system which gives priority to men and subordinates and disempowers women. There was great resistance to the idea of putting domestic and sexual violence against women under the same concept as police violence, since such violence was interpreted basically as a product of the power relations between classes. It was necessary to establish new frames of interpretation with organized women's

groups and new forms of organization in order to convoke, mobilize and involve women in collective action to deal with violence against women.

As noted by Muller and Surel (1998), whatever the reasons why a social phenomenon comes to be seen as a serious issue (increased frequency or unexpected nature of the cases involved, for example), it is essential that such phenomena should be interpreted or defined by the actors directly involved, who should prepare explanations and accounts of the problems experienced. This interpretation is not only supported by the weight of the material nature of social phenomena but is very often also made possible by the emergence of new interpretative norms for social and/or human matters.

In the case of the feminist and women's movement, the formulation of new frames of interpretation was the result of the relations between members of the international feminist movement and women's organizations inside Chile.

Exile became the most important link between the national and international expressions of the feminist movement, as well as a means for the dissemination of new ideas and forms of organization within the country. The critical experiences of women who had to leave the country because they were left-wing militants or companions of exiled persons and who had to relate with their companion and family in new circumstances made them sensitive to the ideas spread by the vigorous feminist movement between the mid-1970s and mid-1980s in Europe and the United States. The international feminist movement's rejection of the Chilean military dictatorship made it all the easier to progress from the struggle against the dictatorship to rejection of the subordinate position of women, with support for the resistance in Chile being combined with militancy in women's organizations. These feminist collectives, which were more flexible and less vertically organized than the political parties or trade unions, fostered the establishment of closer and fuller relations and provided their members with affective and psychological support. All this favoured a new interpretation of women's life experiences. Matters previously seen as private began to be reinterpreted from the point of view of discrimination against women and inequality between the sexes.

The establishment of the Study Circle on the Status of Women in 1977 was extremely important in terms of the formulation of new frames of interpreta-

tion and their dissemination in other organizations. The origins of the Circle lie in the relations of friendship and political sympathy that grew up between women who had been active members of left-wing political parties and/or were now working in human rights organizations or organizations designed to show solidarity with the less privileged sectors. At the time of its establishment they were also united by their great sensitivity to the situation of subordination and disadvantage suffered by women and their interest in embracing new ideas that reinterpret the relations between the sexes. Furthermore, the acceptance of the Circle in the Academy of Christian Humanism was a first recognition among those opposed to the dictatorship that the situation of women could be considered as a major object of study and social concern.

The Circle became part of the network of feminist organizations that began to grow up in Latin America and the Caribbean after the First Feminist Encounter in the Region (Bogotá, 1981), and its members participated in the international meetings on women that were held, beginning with the World Conference on the United Nations Decade for Women (Copenhagen, 1980). It also became the meeting point for women returning from exile. Its members oriented their activities towards other women, who were invited to take part in self-awareness groups where, as a form of testimony and with the support of others, they could share their ideas on the different forms of subordination and assert their desire for and commitment to the attainment of changes in the power relations between men and women. Such collective experience is essential in order to overcome the individual tendency to attribute painful experiences to casual circumstances or factors of a personal nature.

The spread of the new ideas within organizations such as the Commission on Women's Rights (CODEM), the Working-Class Women's Movement

(MOMUPO) and the solidarity-oriented organizations of the Vicariate gave rise to a lively debate between women who had already embraced those ideas and the rest of the members of those organizations. The interpretation of violence against women as an extreme expression of the male power that is present at all social levels, including left-wing and lower-class sectors, was considered to be in contradiction to the priority given to class inequalities and, furthermore, it was seen as a divisive move designed to distract women's attention from the main problem: the dictatorship. In some cases, when the conflict grew more acute the women who supported the new interpretations on discrimination had to leave the organizations and form their own collectives.

To sum up, in this first phase several different factors came together at the national and international levels, generating the conditions for the emergence of a new social movement that reinterpreted the life experiences and situations of women and their relationships with men. As we have seen, the conjunction of the features of the prevailing political context with the new organizational resources, collective dynamics and frames of interpretation provided fertile ground for the appearance of the movement against domestic violence. The relative slackening of the massive and indiscriminate repression that had marked the first years of the dictatorship and the international repudiation and isolation of the latter, together with the international support given to the opposition forces, facilitated the emergence of new organizations and collective dynamics aimed at furthering the rebuilding of the social fabric and the struggle against the dictatorship. The new frames of interpretation positing the existence of an unjust system of social relations between the sexes allowed women to reinterpret their experiences in terms of a new system of inequality and to commit themselves to changing those unjust relations between the sexes.

III

Formulating the issue of domestic violence and securing its inclusion in the public debate (1983-1990)

From the mid-1980s on, the protest movement and popular resistance to the dictatorship and the spaces for action and participation against the dictatorial regime expanded gradually but steadily. Various different strategies were used in the struggle against the dictatorship, reflecting the different conceptions of the opposition forces on change and the recovery of democracy and their individual assessments of the power relations on the political scene.

In 1983, the mass social movement became highly visible: this was the year of outright protests and direct confrontation with the regime. After the attempt to assassinate Pinochet in 1986, however, this strategy gave way to negotiations by the parties in search of a political way out from the dictatorship. This culminated in the 1988 plebiscite, which resulted in a decision to put an end to the dictatorship and introduce a democratic regime within two years. By the end of the 1980s the resistance against the dictatorship took on a more political nature, in the traditional sense of the term. The parties began to play a more active part and fulfilled their traditional function as a bridge between society and the State, and they became the preferred place for dealing with the public issues that were to be considered on the agendas of the coming democratic governments.

The spread and formal establishment of the question of domestic violence as a public issue were influenced by the changes taking place in the political and social contexts.

By the end of the 1980s, after having originally been a problem raised and mobilized by women in order to make it more visible, check it and deal with its different forms, domestic violence began to win itself a space on the public agenda. The new political opportunities that opened up after the plebiscite and the imminent return of democracy eased its incorporation into that agenda, as well as the participation of new actors who came from other social fields and/or were active members of opposition political parties

in the debate on the causes of the problem and private and public ways of solving it.

During this phase, a new political domain was constructed around sex discrimination. Its participants included various women's organizations, groups and collectives spreading a different discourse on discrimination and promoting new social practices to deal with it. The emergence of feminist NGOs played a central role in this. Their activities, aimed at disseminating new ideas on the real situation of women and relations between the sexes, within the narrow public spaces left open by the dictatorship, received international support, which helped to give continuity to the activities embarked upon. The feminist NGOs established relations with women from all walks of life, but especially those in an under-privileged situation: women from the lower urban strata, peasants and indigenous women.

Let us take a closer look at this process. Around 1983, the formulation of sex discrimination and domestic violence as social issues reached a level of visibility which reflected the emergence of a new collective concern, and it also made possible the formulation of a new frame of interpretation on discrimination against women, as well as more flexible forms of organization which favoured exchanges of views and discussions among women.

In 1983 the Study Circle on the Status of Women gave way to "La Morada" and the Centre for Studies on Women's Affairs, while in 1984 the Women's Information and Communication Service (ISIS) set up its regional headquarters in the country. Other important NGOs, such as the Casa de la Mujer in Valparaíso (1987) and the Instituto de la Mujer (1988) were also established from the mid-1980s on.

Within this new political domain generated around discrimination, a new subject—that of domestic violence—also took shape, linking together a number of organizations and persons interested in denouncing such violence and providing psychologi-

cal and legal support for maltreated women. The participants in this new field of concern shared the conviction that it is necessary to strengthen the position of maltreated women, open up spaces for the expression of their pain, aspirations and expectations, and organize them on a collective basis as a preliminary step to transforming the relations between men and women. It was hard to distinguish institutional commitment from personal commitment, as the institutions and organizations active in this field were deeply impregnated with the characteristics of their members.

Social concern about violence was thus based on the existence of a larger political domain. The relation between the two was complex and changed over time. The political domain concerned with sex discrimination provided a frame of interpretation for actions against violence, while it also allowed this to be understood from a more systemic perspective as violence against women –as expressed at the beginning of this phase– and not just as cases of women who had been mistreated and beaten. At the same time it proposed a new way of tackling violence, based on the principles of self-awareness and the collective expression of painful experiences as part of the healing process. It also provided a network of relations and links between organizations and persons, to be used by those committed to the study of this problem.

This wider political domain, however, also had other priorities and demands for its own strengthening. Furthermore, the energy and time devoted to the struggle against the dictatorship diverted attention from the specific problem of domestic violence. Consequently, those committed to the study of this problem had to make an effort to attract attention and obtain support for their activities. In reality, they had to generate their own public among the persons and institutions active in the field of combatting sex discrimination, but their task was facilitated at the beginning by the fact that the differentiation of the problem and of ways of dealing with it was of great importance for the women's movement as a whole, as the topic created and strengthened links between women from different social strata: upper-, middle- and lower-class women, professionals, activists or housewives. Sharing their experiences of the different forms of violence allowed all of them to overcome social barriers and reduce any misgivings about the possibility of one group imposing its ideas on another.

Initially, the women who entered this field were women who had arrived at this point by different paths that were not always mutually exclusive but shared as a common denominator their affective proximity to the problem: a proximity due to the fact that they had been witnesses of the use of violence against their mothers when they were children, they had suffered such violence themselves at the hands of their partners, or they had been deeply affected by the experiences of violence suffered by other women. They were all united by a sense of frustration and impotence which became a powerful source of energy once they had the opportunity to express and discharge their feelings collectively. The arrival of feminist foreign nuns was of fundamental importance for creating an awareness of the need to tackle the problem. Furthermore, in view of the high degree of legitimacy of the church at that time, the possibility of organizing themselves and participating in that social field represented a great stimulus for maltreated women.

As Valente (1994) shows, the assimilation of new and controversial ideas is facilitated when people with social prestige accept them. In order to accept new ideas, people do not only trust their own opinions but also take account of those of their friends and neighbours and of the most influential persons in their social environment, thus reducing the degree of uncertainty involved in the acceptance of such ideas.

Organizations and individuals played different roles in the field of domestic violence, and this strengthened the activities of each of them.³ Some groups specialized in dissemination work and in fostering sensitivity to this issue through campaigns. Others were responsible for furthering the organization of women in lower-class sectors. Some institu-

³ Outstanding in this field are feminist organizations with a political and movement-oriented approach (La Morada; La Casa de la Mujer in Valparaíso, for example); organizations engaged in the dissemination of information and the provision of training and support for the creation of networks (ISIS; La Morada); movements aiming to exert an influence in the political field (Movimiento de Mujeres por el Socialismo; Concertación de Mujeres por la Democracia); organizations that seek to establish links between women of different social sectors (Colectivo Chile-Canadá and La Morada, for example), and other organizations devoted to the dissemination of women's rights (RIDEM) and the establishment of links between the different actors (Movimiento por la Emancipación de la Mujer Chilena).

tions provided support services, and finally, there were also organizations and persons engaged in generating greater knowledge and information on the problem.

Nor was there only a single type of leading figure. The different types of leadership increased in number in the process of formulating the problem of domestic violence, spreading its study into new fields, and generating the social force needed to sustain their tasks. Some figures were undisputed leaders because of their capacity for interpreting, defining and redefining the significance and implications of domestic violence from new perspectives and from the analysis of the accumulated experience. Others stood out because of their capacity to link together women from different sectors and to move smoothly between different organizations and institutions. The importance of some others lay above all in their links with other public spaces, such as those of human rights or political opposition, for example, while still others were noted for their assertiveness, energy, capacity for hard work and dedication.

The initiatives and forms of communication arose from different points, forming a communication network on domestic violence involving various types of women's organizations: feminist organizations, collectives from the lower-class sectors, and other organizations closer to political parties.

The quality and frequency of the links among those making up this network gave rise to a dense but flexible horizontal structure of relations which facilitated the communication and assimilation of new frames of interpretation and the generation of consensus. This network was also marked by a climate of solidarity, mutual confidence (affective links) and cooperation in pursuit of a common objective.

The frequency and intensity of the links also fostered a change in the subjective definition of the everyday life of women. The groups they formed and their face-to-face communication with each other formed the necessary social basis for reaffirming the new feelings and definitions on violence (see Berger and Luckman, 1968). However, the nature of these links tended to cause this space to close in on itself, because it grew almost exclusively in terms of women who were suffering or had suffered situations of violence. Although this can be a positive feature when beginning to build up a political domain, it can become an obstacle when trying to open up to other

sectors and actors. The political context of the dictatorship naturally helped to foster this tendency to form a closed group and obscured the possibility of seeking support or co-responsibility on the matter from other social actors or movements and still less from the public institutions.

As from 1987, the political situation in the country gradually changed. The many NGOs served as the nucleus for a political discussion space shared by the various forces that opposed the dictatorship and were struggling for the country's return to democracy. Various citizen initiatives were organized, among them the *Asamblea de la Civilidad*, which was the forerunner of the *Concertación de Partidos por la Democracia* and in which women took part and put forward their own ideas and demands.

The preparations for the 1988 Plebiscite and the subsequent participation in it further expanded this space for public debate, through the convergence of different discourses in a common arena. The formation of the *Concertación de Partidos por la Democracia* also made it possible to exchange ideas and interpretations on the situation in the country and the urgent problems that needed to be tackled, while the reincorporation of the feminists into the left-wing parties facilitated the access of proposals on discrimination against women and domestic violence into the newly recovered political parties spaces.

In this setting, independent and militant feminists formed the *Concertación de Mujeres por la Democracia*, which reflected both the effort of women to bring the problems connected with the prevailing relations between the sexes into the public spaces now open, and the degree of visibility that women had acquired as political subjects. The *Concertación de Mujeres* generated a new and broader area of convergence, involving different frames of interpretation of the situation of women. Although many of the *Concertación's* members (some 50% of the Council of the *Concertación*) already acknowledged and were known for their feminist ideas, an equally large percentage still approached women's issues from the standpoint of their own fields of professional specialization or because of their parties' interest in gaining access to a new social base.

The activists in the field of the fight against domestic violence gained access to the *Concertación de Mujeres* indirectly, through the most outstanding leaders in the political domain of sex discrimination.

Their incorporation into the recently created Latin American and Caribbean Network Against Domestic and Sexual Violence, however, gave them a new international public space which made them more visible, gave them a leading role, and allowed them to gain priority for domestic violence over other issues also promoted by the feminists.

The establishment of the Chilean Network Against Domestic and Sexual Violence (REDCHVD), for its part, was to represent a higher degree of institutionalization of the coordination among organizations and persons active in this field. Finally, the organization of an international meeting on violence against women in the Santiago suburb of Conchalí not only brought the subject before public opinion but also highlighted the close links between national and international action.

Although the relations between those involved in the social field of violence—especially between professionals and experts on the one hand and middle- and lower-class women on the other—continued to be fluid, there were some tensions. At the end of this phase, the non-professional activists and the representatives of the urban lower-class sectors began to lose visibility and influence compared with the expert knowledge of the professionals and the political party militants. At the same time, many of those who had been known mainly as members of social movements or organizations also asserted their party membership. Thus, the collectively inspired social movement gradually ceased to be the main actor in the task of bringing the question of domestic violence into public spaces.

In this new social and political setting, the debate with other actors enriched the definitions and possibilities of action to deal with violence, while making them more complex. The broadening of the public debate and the experience accumulated in previous years fostered and at the same time reflected changes in the conception of domestic violence and the strategies proposed for dealing with it.

At first, domestic violence was interpreted as an expression (in the most extreme terms) of the unequal power relations between men and women. Within that interpretation, self-awareness and self-help groups became the main strategy for tackling that violence. They made it possible to make up for the psychological vulnerability of the victims, who were now able not only to communicate an experience suffered for a long time in silence, but also

to stop being passive, helpless victims and instead feel that they were leading actors in their own lives within a collective process that united them with other women. Facing up to violence was then seen as a matter for women themselves, and it was considered that the solution of this problem depended largely on the level of organization and strength that women could generate.

Little by little, however, it became clear that not all women who suffered violence could become militants of the movement, so that it was necessary for the State to organize services—hopefully of adequate size and quality—to give individual attention to victims. It also became clear that merely becoming aware of the problem did not necessarily lead to changes in forms of behaviour and attitudes, which frequently called for more specialized support and thus went beyond the mere will for change. Feminist psychologists highlighted the complexity and density of the problem and showed that both men and women took part in the formation of violent situations, albeit with very different levels of power. The continued occurrence of these types of situations, in spite of women's higher level of awareness, aided a more systemic and dynamic interpretation of the problem and opened up a broader space for the participation of feminist professionals in two specific fields: those of legal matters and of psychology.

Furthermore, in order for the problem of domestic violence to begin to be considered as a public issue, it was necessary to open up a place in the discourse on violence raised by the forces opposing the military regime. This was achieved by emphasizing the similarities between domestic violence and violence in general, but this represented a challenge to the version of the causes of violence hitherto prevailing in that field, because it showed that domestic violence was not rooted exclusively in the class struggle but was also due to the unequal social relations between men and women.

The greater visibility achieved by women thanks to the new organizations and collective dynamics was accompanied from an early stage by the generation and dissemination of knowledge, in order to reveal the existence, magnitude and consequences of domestic violence and assert the fact that it was a public issue.

The social and political actions undertaken were backed up right from the start by the results of stud-

ies on this subject carried out both in Chile and abroad. At the same time, the continual increase in the demand for help by women who were victims of such violence was evidence not only of the magnitude of the problem but also of the social force underlying women's demands.

The changes in the conception of domestic violence and the new political opportunities favoured the expansion of the strategies proposed for tackling the problem: incorporation of the problem on the agendas of the political parties and institutions, negotiation with the political forces of the Concertación de Partidos por la Democracia and the future government, promotion of reforms to the law, and implementation of public services to tackle the problem. This made it necessary for the problem to be passed through the filter of expert opinion and the codes of the political parties.

IV

The institutionalization of the problem of domestic violence at the level of the State

With the restoration of democracy, the political setting changed and there was a decisive increase in the opportunities for spreading and discussing the new ideas generated in different social fields: women, human rights, indigenous problems, and young people. A new type of relationship was established between the State and society at large which was to give rise to new spaces for contacts and discussions among the State, political and social actors.

The Concertación de Mujeres por la Democracia presented the new government with an agenda on sex-related matters and specific proposals on how to tackle problems deriving from the positions of inequality suffered by women. It called for the establishment of a new institutional mechanism responsible for coordinating policies from the standpoint of gender (the National Women's Service - SERNAM) and proposed that more women should be appointed to positions of authority.

The triumph of the Concertación de Partidos por la Democracia also opened up the State to persons who had been members of the opposition in the re-

In short, during these years domestic violence finally emerged as a social issue and gradually won for itself a place on the agenda of public problems.

At the start, the process was marked by the constant incorporation of new and varied groups of women with strong links among themselves, which made possible the growth and strengthening of a political domain. The expansion of opportunities for political activities favoured more open discussion of the public agenda and the future institutional agendas and forced the actors who had been formulating domestic violence as an important issue to learn new procedures, while also giving rise to pressures for the change or replacement of some groups and leaders. At the end of this phase, the women's movement opened up to new spaces and established links with actors from other political domains, thus facilitating the spread of the issue beyond its initial ambit.

cent past and who had devoted part of their time to working in some NGO or other civilian organization, thus making such persons an important source of professionals and officials for the central government and some local levels of government: a situation which was particularly marked in the institutions which had only recently been set up. This shift of some of the actors who had conceived and formulated new public issues when they had been members of the public at large thus became an extremely important mechanism for allowing them to get inside the State institutions and design policies for tackling the issues they had raised.

In these circumstances, the political domains which had grown up in past decades underwent changes, both in the type of actors participating in them and in the relations between them. They now incorporated actors from other social and political fields, as well as State authorities and officials.

In the specific case of domestic violence, many of the women who had played leading roles in the previous phase entered SERNAM or formed part of

pilot projects at the central or local level of government (in centres for aiding women who were victims of violence or in offices for women's affairs, for example). There were also other actors who gained greater importance and decision-making power: SERNAM, the Interministerial Commission on Intra-Family Violence, the corresponding programme of SERNAM, and the staff of centres for aiding maltreated women, the first of which were set up in the municipalities of Conchalí, Santiago, Huechuraba and El Bosque.

The new institutional, political and social actors thus incorporated approached this subject from broader institutional and ideological positions than in the past. Consequently, the links which had in the past mainly been between the women in NGOs and those in social organizations, as well as, to a lesser extent, with feminists in the political parties, now shifted to a new axis: the interaction between the State and society at large. Thus, the actors in civil society formed links with those in the institutions, especially SERNAM, the Interministerial Commission on Intra-Family Violence, and some municipalities, mainly through the Chilean Network Against Domestic and Sexual Violence (REDCHVD).

REDCHVD played a fundamental role in this new structure of the social domain of domestic violence. It represented the direct continuation of the conceptions, interpretations and feelings constructed in the previous decade. It was also the point of linkage with the international movement against violence and reception point for new ideas and proposals, and it continued to be based on the joint action of NGOs and grass-roots organizations. It asserted the importance of the organizational, political and ideological autonomy of the social actors *vis-à-vis* institutional interests (for example, any member of REDCHVD who entered the government had to withdraw from the Network in order not to compromise its independent status). Nevertheless, REDCHVD now operates in a different manner from that of the past: it organizes the relations between its various members in a more formal manner and gives priority to links with political and State actors in order to promote policies.

The priority that REDCHVD now gives to the adoption of laws or the implementation of services for maltreated women represents a change from the position of the old actors in the social domain of the struggle against violence. Since social problems must now pass through the filter of expert opinion

before they can be institutionalized, the main positions in REDCHVD are no longer occupied by middle- and lower-class women, who have made way for feminist professionals with an expert knowledge of legal matters and services. This has heightened the tensions among those active in this domain. The original promoters of the grass-roots organizations now feel left out as a result of the importance acquired by the professionals.

The establishment of the Interministerial Commission on Intra-Family Violence, for its part, which was set up by the Executive in 1992, is headed by SERNAM, and includes representatives of different sectors of government –the ministries of Health, Justice, Education, External Relations, Interior (Carabineros), Office of the Secretary-General of the Presidency of the Republic, and National Institute for Youth– opened up spaces within the State for the discussion of this newly recognized issue. SERNAM was responsible for persuading and convincing the different sectors of the urgency and importance of the issue and for facilitating its translation into the codes of each of these sectors. The invitation to REDCHVD to take part in that Commission reflected SERNAM's desire to maintain its links with civil society and increase its force and power of persuasion *vis-à-vis* the other sectors.

The Interministerial Commission on Intra-Family Violence gave its members the possibility of exchanging and modifying their conceptions on violence and relations between the sexes, of discussing the responsibility of their sectors in preventing and dealing with violence, and of identifying the resources that could be transferred to the programme against violence implemented by SERNAM. The presence of REDCHVD was an important factor in achieving these aims, as it could speak out about the significance of violence freely and independently of the logics of the individual sectors and could analyse it in the frame of interpretation of gender discrimination.

To sum up, the process of institutionalization of the problem of domestic violence within the State was initially propelled mainly by persons already committed to this matter, who mobilized their own personal networks to set in motion actions of an institutional nature. REDCHVD was the most valid and representative champion of women's interests in this respect *vis-à-vis* SERNAM, the government and the parliament, and it acted as a bridge be-

tween the already existing movement to combat violence against women and the new State institutions involved in this.

The general agreement and homogeneous conceptions, values and guidelines that characterized the social domain of the struggle against violence in the 1980s had been weakened by this time, thus giving rise to pressures for more specific agreements or for more general and abstract approaches in which the idea of violence as an expression of the power relations between the sexes had been diluted. Even so,

this greater heterogeneity of actors and interpretations decisively aided in placing the issue within a broader public debate.

The definition of domestic violence as a policy object was easy to accept. The distance covered by other countries of the region in the discussion and adoption of laws against violence and the implementation of public services for this purpose legitimized women's policy proposals to the government and reaffirmed the State's responsibility for dealing with this problem.

V

The preparation and processing of a law against violence

The preparation, discussion and adoption of a law against violence meant that the problem must now gain access to a new agenda and a new institutional space: that of the legislature.

In this space, actors who were now active in it but had previously been close to the social movement created to deal with the problem of domestic violence sought to bring the issue onto the legislative agenda. Thus, for example, the female member of parliament who presented the first draft law had been an active participant in the women's movement in the 1980s, which was reflected both in her links with some feminist professionals for the preparation of the draft and in the frame of interpretation underlying the proposed law.

The incorporation of the issue into the legislative agenda and its subsequent progress therein made it necessary to redefine the problem under special conditions: expansion of the number of actors and positions (which increased the spaces and subjects of confrontation) and the application of new, strict rules which delimited the field in terms of discourses and procedures.

In view of the formal and specific nature of the legislative context, the actors must be specialized and must be familiar with the rules in order to recognize the limits that apply to their actions and know how to make use of the possible spaces for action. The legislature demands from its actors a style of discourse based strictly on arguments and subject to certain ba-

sic guidelines: the prevailing constitutional and legal principles, the accepted definition of the functions of a legislator, and the fundamental values on which the understanding of society is based. The actors are subject to certain demands in terms of dialogue, since this space is obviously one of confrontation.

These characteristics also mean that the relations with actors from other spheres are clearly subject to the logic of the legislature. In other words, all the demands or problems presented as inputs for the debate must conform strictly to the rules of parliamentary procedure.

Institutionalization in terms of the legislature means dealing with two areas of controversy. One is that of the different issues that are competing for a place on the agenda, by showing not only their existence and importance and the need for legislation on the matter, but also the urgent need to do so. A large part of the arguments of the members of parliament who were promoting the question of domestic violence were designed to prove that this problem could not be solved merely by generating and approving social programmes. Agreement was reached on this subject without too much resistance, and the Executive intervened to give the proposal a degree of urgency.

The second area of controversy was that of the confrontation between different versions of the problem. The frames of interpretation did not appear simultaneously but emerged gradually in the course of

the process, as a function of the cultural conceptions and political interests of the actors.

In the case in question, there were three competing frames of interpretation: that of discrimination, that of human rights, and that of the family.

The first of these, which inspired the first draft law on the subject and was supported by the most progressive political sectors, held that women are the juridical good that is to be protected, and interpreted domestic violence as one expression of the global situations of discrimination and authoritarianism that women suffer in society. The second, which was based on the concept of human rights and made its appearance when the draft was being discussed in the Working Commissions of the Chamber of Deputies, was mainly concerned with the family and considered domestic violence as an offence against universal human rights; the main argument for this position was the need to comply with the international conventions signed by the government. Finally, the frame of interpretation based on the family, which emerged when the draft was being discussed in the Senate and was supported by the most conservative elements, considered that the family was the good that the State should protect, as this guaranteed the maintenance and sound health of society; the arguments in support of it made abundant reference to the consequences of violence in the home but did not refer to women as a subject of law. This process of

confrontation between the different discourses was reflected in the change in the name of the law from "domestic violence" to "intra-family violence", indicating that it was the latter frame of interpretation which would prevail in the spirit of the law.

The different positions made use of their own types of strategies and resources: types of arguments, methods of exerting pressure, and utilization of sources of power (use of public opinion, powers of the Executive, etc.). The latter turned out to be an extremely important non-discourse-based resource. In addition, each of the positions changed, guided or modified the use of these resources as a function of new evidence, progress in the discussions, and the objectives considered to be most important at the time of the discussion, such as, for example, first of all securing agreement to legislate and then achieving consensus, in order to facilitate the continuity of the process.

The existence of different frames of interpretation slows down the processing and adoption of a law. Thus, the different and opposing positions in the Chamber of Deputies and the Senate⁴ on the problem of domestic violence made it necessary to use one of the established procedures: the intervention of the Executive to veto the law. This made it possible to get out of the stalemate and adopt a negotiated law representing a compromise between the different positions.

VI

Conclusions

In this article, we have analysed the process whereby, in the space of less than 25 years, an issue which was absent from Chilean and international debates and legislative agendas came to be a recognized social issue which has now given rise to a high level of consensus on the need to stamp it out as a social practice. This process was long enough to generate a political domain and give rise to new discourses on relations between the sexes. In this sense, the formulation of the experience of violence as a public issue was also the history of the constitution of women as social subjects, of their organizations, and of their strategies for propelling the matter ahead in different political contexts.

Different phases were to be observed in this process, depending on the characteristics of the political and institutional system and the political opportunities offered by it, the different types of actors taking part, the organizational resources at their disposal, the feelings guiding the interpretations and actions of the actors, and finally, the different social settings in

⁴ Among the most significant amendments made by the Senate in the draft law sent to it by the Chamber of Deputies were the weakening of the preventive measures, the incorporation of the concept of the degree of ill-treatment, and the decision not to set up special courts.

which the process took place. These different settings were governed by their own logics, which the actors had to deal with and respect if they wanted to influence or act in them.

Each of the phases was also marked by the particular structure assumed by the links between the actors. In the first phase, the efforts to construct the problem and the political domain organized around domestic violence gave rise to a relatively broad and dense network with a high degree of interconnectivity and with the presence of various important actors of high prestige. This network structure made it possible to generate rapid consensus on the interpretation of violence. Furthermore, the multi-centre nature of the network reflected greater democracy and a less hierarchical relationship in the links that were established. In the third phase, with the incorporation of institutional and political actors, the network became more differentiated, the links lost the dense and horizontal nature which had previously characterized them, so that they became more hierar-

chical, and reaching interpretative consensus became more difficult and slower.

This article also highlights the dynamic and complex nature of this process, whose results were not and could not be determined in advance. Indeed, neither the way of interpreting domestic violence when the law was adopted, nor the final outcomes of the process were contained in its initial bases or in the initial political action of women. On the contrary, the interpretations and objectives changed and became more complex over time, as a function of the different actors who were becoming involved or were withdrawing from the process and the changes in the feelings that guided them.

To sum up, the article shows that public issues do not exist in their own right as objective entities, but are constructed by actors who take part in the different settings, in which they exchange and confront discourses based on different frames of interpretation.

(Original: Spanish)

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Options for rural *poverty reduction in* Latin America and *the Caribbean*

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Although most of the total population and the majority of the people living in poverty in Latin America and the Caribbean are in urban centres, poverty is, in relative terms, still a rural phenomenon in the region. The incidence of poverty and of extreme poverty is much larger in rural areas than in urban settings. As recently as 1997, more than half of all rural households were living in poverty, and close to a third of them were in extreme poverty conditions. Moreover, the fragile economic situation of most countries in the region during the past two years may well have worsened those figures. The rural poor in the region face at least three basic challenges: (i) inadequate nutrition and poor health and educational services; (ii) few opportunities for productive employment in agricultural and/or non-farm activities; and (iii) lack of sufficient levels of organization to lobby effectively for rural interests. The number and diversity of circumstances that cause rural poverty, as well as the heterogeneity of rural poverty conditions across and within countries and regions, constitutes a challenge to develop cost-effective solutions to improve the well-being of rural inhabitants. The objective of this article is to highlight several options for the reduction of rural poverty in the region. It therefore focuses on three important and complementary options for generating and raising income levels among the rural poor: those based on growth in the agricultural sector, those targeting the sustainable use and conservation of natural resources; and those based on the growing significance of rural off-farm economic activities. There are at least two other options for reducing rural poverty: the traditional migration to urban areas, and targeted assistance to those who need income transfers to either rise above the poverty line and/or have minimum access to safety nets.

I

Introduction

Although 74% of the population and 62% of the people living in poverty in Latin America and the Caribbean are in urban centres, poverty is, in relative terms, still a rural phenomenon in the region. The incidence of poverty and extreme poverty is larger in rural areas than in urban settings. Moreover, rural average incomes are significantly below urban incomes. In 1997, approximately 75% or more of the rural inhabitants of Bolivia, Ecuador, Guatemala, Haiti, Honduras, and Nicaragua were below the pov-

erty line. In Brazil, Mexico and Colombia (the countries with the largest rural poor populations, with approximately 20, 15 and 6.5 million respectively) between 56% and 62% of the rural population was below the poverty line (ECLAC, 1999). The number and diversity of circumstances that cause rural poverty make it difficult to develop cost-effective solutions to improve the well-being of rural inhabitants, but this article aims to highlight several options for the reduction of rural poverty in the region.

II

The magnitude and heterogeneity of rural poverty

More than a quarter of the population of Latin America live on less than one dollar per day. The largest concentrations of poverty are in Central America, the Andean region and northeastern Brazil, where close to 60% of the inhabitants live below the poverty line. The percentage of the region's rural households living in poverty dropped by only two percentage points between 1994 and 1997, from 56% to 54%, while the share of rural inhabitants living in extreme poverty decreased from 34% to 31% during the same period (table 1). In spite of this modest progress, the 1997 figure for rural poverty (54% for the region in relative terms) was still similar to that of 1980, while the figure for extreme poverty was even higher than before (31% vs. 28%).

Since the beginning of the 1990s, the urban poor (primarily female heads of household, fathers with little or no formal education, and unemployed young people) have for the first time become more numer-

ous than those in rural areas, with the former currently estimated at slightly over 126 million and the latter group at 78 million individuals (table 2). However, more rural than urban people live in extreme poverty (47 million vs. 42.7 million), in spite of the fact that a high percentage of the poor living in urban areas are new or recent arrivals from rural areas. The modest decrease in the percentage of households living beneath the poverty and extreme poverty lines in rural areas in the 1990s (from 58% and 34% to 54% and 31%, respectively) has not prevented an increase

TABLE 1
Latin America: Percentage of households living in poverty and extreme poverty, 1980-1997
(Percentages)

	Poverty			Extreme Poverty		
	Total	Urban	Rural	Total	Urban	Rural
1980	35	25	54	15	9	28
1990	41	35	58	18	12	34
1994	38	32	56	16	11	34
1997	36	30	54	15	10	31

Source: ECLAC (1999).

□ The author gratefully acknowledges the suggestions made by an anonymous referee of *CEPAL Review* and the comments of Martine Dirven. The views expressed in this paper do not necessarily reflect those of the organizations mentioned.

TABLE 2
**Latin America: Number of persons living
 in poverty and extreme poverty, 1980-1997**
 (Millions)

	Poverty			Extreme poverty		
	Total	Urban	Rural	Total	Urban	Rural
1980	135.9	62.9	73.0	62.4	22.5	39.9
1990	200.2	121.7	78.5	93.4	45.0	48.4
1994	201.5	125.9	75.6	91.6	44.3	47.4
1997	204.0	125.8	78.2	89.8	42.7	47.0

Source: ECLAC (1999)

in the absolute number of individuals affected (compared with the 1980s). Furthermore, the fragile economic situation in most of the region during the last two years (1998 and 1999) may have worsened rather than improved the already severe figures.

Rural poverty is more extreme than urban poverty, and it seems harder to overcome. In many countries of the region, the rural poor have yet to benefit from recent economic growth. Unequal distribution of land and distortions in the market for agricultural inputs and services have contributed to persistent rural poverty. Although there is great variation in the incidence of rural poverty across and within countries, the magnitude and incidence of the problem is such that there is a great need for effective programmes to reduce such poverty. Among the more urbanized countries, migration to the cities is beginning to decline, but in countries where rural inhabitants account for over 25% of the total population, high rates of urban migration continue to prevail. It is crucial to create suitable conditions for enabling the rural population to achieve living standards (economic, political, social and cultural opportunities) comparable to those enjoyed by urban dwellers.

Paradoxically, even though the agricultural sectors of most countries have experienced significant

growth in the 1990s, marginalization and rural poverty are not declining. However, it is also clear that economic growth has played a role in at least reducing the increase of rural poverty, through an increased demand for labour and the resultant migrations, which show that part of the solution lies outside the agricultural sector itself. As a result, non-farm income has become more significant in total rural income, reaching levels of 68% in Haiti, 59% in Costa Rica and 51% in Argentina and standing close to 50% in a 13-country average (Reardon and Berdegue, 1999). Yet, economic growth has not been sufficient in all cases, which indicates that extreme poverty conditions in rural areas can only be improved through targeted programmes.

Who are the rural poor? Although there is no recent information, at the end of the 1980s small-scale farmers represented the largest share of the rural poor (over 60%), while the landless population and indigenous groups and others accounted for 30% and 4%, respectively (FAO, 1988). By various counts, at least one-third of those small producers were subsistence farmers with limited opportunities for overcoming poverty via agriculture. This indicates that between 40% and 50% of the rural poor may have very limited access to productive resources with which to generate sufficient earnings from agricultural production itself. Furthermore, the number of rural poor with less access to agricultural resources is growing faster than that of those with more access.

The rural poor in the region face at least three basic challenges: (i) inadequate nutrition and poor health and educational services; (ii) few opportunities for productive employment in agricultural and/or non-farm activities; and (iii) lack of sufficient levels of organization to lobby effectively for rural interests. The options to reduce rural poverty discussed in this article are based on these challenges, as well as on the heterogeneity of rural poverty conditions across and within countries and regions. Before analyzing those options it is worth reviewing the new regional context for rural development and some lessons learned from past experience.

III

The new regional context for rural development

Several major trends affect the changes taking place within the region's rural areas: growing economic integration and trade liberalization; the perceived new role of the State; and the increased awareness of environmental, gender and ethnic matters (Echeverría, 1998).

1. Increasing liberalization, integration and openness to trade

Bilateral treaties, NAFTA and MERCOSUR, the agreements with the European Community and the APEC countries, and the deliberations for the creation of the FTAAs have all contributed to the further opening of markets and closer integration of the region's agro-food and agro-industrial sector. New market opportunities are causing producers to become increasingly export-oriented, while allowing the importation of agricultural products from outside the region. The desire to become more competitive is leading to greater efforts to increase productivity and quality, resulting in greater concentration or diversification in trade and agro-industry. Developments in this area have been accompanied in many cases (Brazil, Argentina, Mexico and Chile) by the formation of joint ventures with local investors in agricultural and non-agricultural sectors, as well as mergers and greater concentration among national enterprises. The expanding scales of production (particularly in grains, meat, oilseeds and sugar, and also in certain fruits and industrial crops), along with the mechanization, computerization and internationalization of agricultural activities, affect rural employment and land markets alike. In facing the challenges of open competition, the large numbers of small-scale farmers (*minifundistas*) working marginal land and with only limited access to education, technical advances, communications and information, are at a considerable disadvantage. Their position *vis-à-vis* markets leaves little room for this group to be able to compete in an effective and sustainable manner in this new context.

2. A new role of the State

Liberalization through privatization, and structural adjustment to reduce fiscal deficits, have meant not only less intervention by the State in rural matters, but also the dismantling of the organizations traditionally responsible for the agricultural sector, making rural development more difficult until these can be replaced by civil society and the private sector, especially at the local level (Piñeiro, Martínez Nogueira, Trigo, Torres, Manciana and Echeverría, 1999). The reduction or withdrawal of public sector services has been particularly noticeable in some areas of rural life such as social spending (education, health), the financial system, infrastructure and key agricultural services such as technology. Within these areas, the higher the demand for investment in the human capital, credit, communications and research needed to meet the challenge of improving rural competitiveness, the fewer the opportunities available to the rural population to access these services.¹

Those countries that are trying to correct this shortcoming and investing in growth with social equity often face difficulties in developing effective programmes capable of reversing the traditional statism and excessive bureaucracy of their administrations, promoting instead active participation by local communities and the private sector, and enlisting market mechanisms in the effort to reduce poverty. Despite the difficulties, greater reliance on market economics, incorporation of new actors such as NGOs, and the search for a new balance between the

¹ On the other hand, market liberalization and the adjustment programmes have somewhat reduced the urban bias created as a result of the State-led industrialization process, which penalized agriculture as a productive sector while compensating landowners via subsidies linked to land ownership (Binswanger and Deininger, 1997).

roles of the public and private sectors and civil society in development are now a part of the region's new landscape. Yet progress in the transition from centralized States to situations where the State primarily plays a policy-setting role, together with more active participation by non-State groups in the interests of the poorest segments of society, is still weak at best and needs to be fostered more strongly.

3. Growing awareness of environmental, gender and ethnic matters

The great majority of the rural poor live in areas of low agricultural potential, including degraded or semi-arid zones, tracts subject to erosion, or areas of fragile soils and sloping hillsides, in the foothills of the Andes, the coastal ranges of Mexico and Central America, or the arid zones of northern Brazil. This population depends on natural resources for subsistence (water, food, energy and income), yet because of their limited quality and quantity, many have no alternative but to cross the threshold of sustainability and deplete these resources. Despite the region's ample natural resources, the challenges of desertification, destruction of natural resources, climate change and loss of biodiversity add growing pressure to the search for effective means of ensuring sustainable development. For this reason, breaking the vicious circle of deforestation, degradation of water and soil resources and growth of rural poverty is one of the key factors shaping new rural strategies.

The people and governments of the region are increasingly concerned with the quality of the environment. While there is still an urban bias in the allocation of environmental spending, the number of conservation programmes and projects aimed at protecting soil, water resources and forests is growing. The insistence on sustainable management of natural resources not only relates to citizens' demands for a higher quality of life but also represents an opportunity for development of the rural communities themselves. Similarly, the use of environmentally-friendly technology and systems that ensure sustainable development of natural resources also represents an op-

portunity, limited until now, for generating new (organic or green) products, as well as for creating and adopting new technologies which are more accessible to small-scale farmers.

Although there are variations across countries, and in spite of the fact that female labour is sometimes invisible in national statistics, rural women may be responsible for the production of up to 50% of the food consumed in the region. In many countries, it is women who manage farms, gather firewood and water, and look after livestock while their husbands and older children work in commercial farming or urban centres. The proportion of women in the rural work force increased from 21% to 25% of the total between 1980 and 1995 and it is projected to increase to 28% of the total rural economically active population by 2010 (Dirven, 1997). The drop in the relative importance of agricultural activities (and of production for on-farm consumption in particular), expansion of the trade and services sectors, and the spread of paid labour into rural zones have combined to facilitate the entry of women into labour markets, and at the same time to make their participation more visible.

Historically, women and indigenous people have lacked equitable access to land, credit, capital and extension services, even though it is these groups that make the heaviest use of water, soil and forest resources, both to provide the basics for their families and to generate additional income. Recent legislative reforms to correct these problems have resulted in much progress, yet some residual discrimination persists. In many cases, indigenous communities live in the most fragile areas (mainly in isolated zones with low agricultural potential and few options for non-agricultural employment), often adjacent to or within the boundaries of nature reserves. Consequently, the conservation approaches for protected areas (as in the case of any other lands occupied by indigenous groups) would profit greatly by including these communities in their environmental management programmes, guaranteeing the integrity of their territories and improving their access to social services. In addition, rural development programmes specifically targeted to reduce poverty among indigenous groups are needed.

IV

Some lessons learned

As yet, no regional approach has been developed to tackle the full magnitude and persistence of rural poverty in the region, nor have sufficient resources been made available on a consistent basis at the national level for dealing with this issue. Furthermore, the majority of rural projects to date have been discontinuous and unconnected efforts. In some cases, rural policies have co-existed with or attempted to compensate for contradictory policies such as imports of highly subsidized agricultural products, overvalued exchange rates, price controls on basic commodities, and high interest rates. Of the various experiences in measures to reduce rural poverty, the following four important lessons may be learned.

1. Promote a favourable policy and institutional framework

Given the vital role that economic and sectoral growth play in the reduction of rural poverty, the promotion of a favourable macroeconomic and sectoral framework is an essential requirement for rural development to succeed. A framework based on the maintenance of stable policies and the establishment of an enabling environment is key to the effective and decentralized execution of projects. This context should include social programmes (safety nets) for those who cannot meet their basic needs. For instance, the targeting of poverty-stricken areas via social investment funds should be extended to many rural areas. Latin America's experience confirms that economic growth alone is not sufficient for reducing poverty. The type of growth and the strategies for maximizing the benefits accruing to the poor are likewise key factors. Economic growth has reduced rural poverty primarily through migration. In addition, agricultural development has also been effective in reducing poverty in rural areas. This suggests that while vigorous growth in agriculture is a central component in rural development, programmes explicitly favouring such development are still necessary (IDB, 2000). The formulation of macroeconomic and sectoral policies aimed at overcoming rural poverty is an essential requirement, but will not in itself

suffice to achieve this purpose. In addition to these conditions, specific approaches such as those listed below will be required.

2. Increase investments in health, education and infrastructure

Progress in terms of the coverage, level and quality of rural health and education programmes has been very uneven. For many countries, achieving the conditions necessary to provide all children in rural areas with the opportunity to complete six years of primary schooling remains a distant goal. For a few other countries, the current goal is to provide full access to a four-year secondary school education for young people in rural areas.² In general, the quality of rural education is lower than for the equivalent urban courses and programmes, owing to the distribution of the population, low enrollment rates and lack of educational incentives in the rural environment. In addition, curricula tend not to take into account the specific needs of students living in rural settings, and they also tend to discriminate against women, indigenous groups and people of African descent, both in the provision of infrastructure and materials, and in the focus of programmes and opportunities for advanced studies. It is important to ensure that such groups not only contribute their labour but also themselves benefit from the income-generating components of social investment programmes.

In view of the growing marginalization of certain regions, their lack of employment options, and the fact that a declining population base often makes it harder to provide basic services for the remaining

² Despite the generally acknowledged importance of education, López and Valdés (1997) show that the returns to investments in rural education in Latin America have been surprisingly low. They report that, on average, an increase in one year of schooling for rural family members increases family income by less than US\$ 20 per person. Apparently the main contribution of rural education is to prepare rural inhabitants for migration to urban areas. These results mask the real need for more education in rural areas in order to make them more competitive, for example by investing more in areas such as vocational training for rural youth.

inhabitants, some trade-off between social spending and local sources of income becomes necessary. The relationship between transport infrastructure and education and health services provides a good example: in many cases, building a road and providing bus transportation is the best solution for isolated rural areas, or setting up a boarding school in a nearby town may be preferable to having a number of schools and teachers scattered about the rural countryside. Investments in health, education and infrastructure aimed at the most disadvantaged sectors can be used to correct some of the income disparities in rural areas.

3. Take rural heterogeneity and participation of beneficiaries into account

The diversity of the rural population, changes in the economic environment and differences in learning abilities among the parties involved in development projects also come into conflict with the rigidities inherent in the formulation and execution of most development initiatives. In addition, the lack of participation by beneficiaries has resulted in the inclusion of components for which there is no demand, failure to adjust projects according to the rate of absorption by communities, and general lack of rural development programme sustainability. The rural poor generally lack negotiating skills and have little influence with governments or international agencies. There are also few professional staff prepared to carry out these programmes and a general lack of understanding of the economic, social and cultural context in which rural development programmes take place.

Most evaluations of rural development programmes note the importance of involving the local population more directly and continuously, from the design through the execution of the activities. Yet in reality there are few cases in which the communities are consulted and participate fully in such programmes. In many small projects, experience has shown that a good level of success and compliance with objectives can be attained in cases where the communities involved have already attained a certain degree of organization and/or where the project strategy allocates a relatively high proportion of resources to training and institutional strengthening. Training activities could be promoted (covering aspects of the country's existing legal framework, orga-

nizational structure and democratic decision-making, and management and administration of organizations and projects) for the purpose of strengthening basic organizational capabilities to participate in rural activities. The training should also include staff of the government agencies responsible for the supervision of rural programmes, in order to facilitate participation by their beneficiaries.

Although there are hundreds of civic and/or non-governmental groups (farmers' associations, indigenous groups, foundations, environmental and civil rights groups, etc.), the great majority of them are only loosely organized and lack technical capacity, thus limiting their potential for participating in rural development activities. Consultations with NGOs, foundations, private companies, cooperatives, trade associations, indigenous federations or communities, national and local government agencies, religious bodies and other similar groups to identify priorities among several competing demands of rural communities and to induce groups with some technical capacity to become involved in the preparation and supervision of projects have proved to be very useful.

4. Improve the implementation of rural programmes

The multiplicity of components, the centralization of decision-making and the weakness of intermediary institutions (regional and municipal) have all hindered execution of development programmes in rural areas. In many cases, clientage-based politics and lack of administrative control have undermined decentralization efforts. Rural projects have encountered problems with the sequential execution of their different components which have adversely affected the ability to achieve their overall objectives. For example, in several cases construction of rural access roads was completed before technical assistance efforts to regularize land tenure began, resulting in uncontrolled land use and reliance on unsustainable agricultural practices.

In general, the rural development programmes carried out in the 1970s and early 1980s have been below average in meeting their physical targets and even less effective in benefiting low-income groups (IDB, 1989). The problems most often cited include lack of institutional capacity, inadequate coordination between executing agencies, and overly ambi-

tious goals. The lack of reliable information has led to inaccurate projections and errors in both cost/benefit analyses and in the selection of objectives and goals, resulting in delays and cost overruns. Nevertheless, many projects have achieved positive results, particularly those that gave access to productive resources and essential services not

previously available to the rural poor, and those that set a positive example in the areas of decentralization and community participation in the design and execution of activities. The need to create the political and institutional setting for the effective and decentralized execution of projects is also an important lesson of past projects.

V

Options to reduce rural poverty

While rural poverty is concentrated mainly in the small-scale farmers with less agricultural potential and the landless group, some of the farmers with agricultural potential are poor as well, primarily because of: restricted access to technology and credit, which prevents them from realizing potential productivity gains; lack of water; uncertainty over land ownership; or weak access to markets for products. The fundamental difference between the rural poor with more agricultural potential and those with less is that the former can find a path out of poverty by overcoming these marketing restrictions, obtaining the necessary financial resources and investing for instance in small-scale irrigation works and new technologies.³

Some of the most important means for generating or raising income among the rural poor are: developing commercial agriculture; providing greater access to land; projects based on available natural resources; promotion of micro-enterprises, and both private and public investment in infrastructure. For simplicity, these options will be grouped into three categories in the rest of this article: those that are based on growth in the agriculture sector, those targeting the sustainable use and conservation of natural resources, and alternatives for the rural non-farm economy.

1. Agriculture-based options

A rural poverty-reduction approach based on agricultural production will require both opening up new opportunities for obtaining scarce resources and overcoming the obstacles that prevent small farmers from realizing the full productive potential of the resources they control. Although the instruments proposed might seem traditional, the methods used to implement them differ from those of the past in that they will operate where possible through the market and the private sector.

a) *Effective land markets*

The region still contains vast tracts of State-owned lands, some of which hold great potential for both agriculture and forestry, with little danger of depleting their natural resources. In addition, there are large private holdings which are not being worked productively. Many small-scale farmers and landless workers would have an opportunity to increase their incomes if they were given access to these resources. After the negative experiences of the 1960s and 1970s, however, the straightforward distribution of land among the landless is not a viable political alternative. The current emphasis on more intensive use of land, based on new technologies, should improve possibilities for subsistence farmers and certain landless peasants (sharecroppers) and result in better opportunities to obtain employment with those farmers that do have land, since intensive farming requires additional labour. Thus, longer-term leasehold contracts, share-tenancy or sharecropping agreements and the distribution of public land to permit access by the poor should be promoted and complemented by programmes to help farmers register

³ Agricultural potential is defined as access to the resources (including land of suitable quality and in sufficient quantity) needed to generate the earnings (or products) that will ensure survival of the farmer's family and development of the production unit. Where this condition is not met, the individuals involved fall into the category of farmers with less potential. This situation can be altered by improving access to land or by encouraging irrigation projects in dry farming areas. Both groups may very well coexist within a single region or micro-region.

ownership of the land they occupy. Other methods may also be used in conjunction with this effort, such as land purchase programmes or the offering of incentives for owners of large holdings to sell inefficiently utilized property, accompanied by programmes to help small farmers purchase it. Similarly, progressive property tax systems that assess the value of land on the basis of its agricultural potential can be used to discourage land speculation and avoid huge concentrations of property.

A recent review of land markets in the region (Echeverría (ed.), 1998) shows that their effectiveness can be increased by avoiding distortions of land use through such measures as ensuring a neutral macroeconomic, fiscal and sectoral context; strengthening property rights and decreasing transaction costs by reforming public lands allocation policies; and eliminating regulations that limit the selling and/or leasing of land. Of the many instruments that can promote land markets (land reform and colonization programmes, land taxes, and title registration projects) those that can do most to facilitate access to land for small farmers in particular are market-assisted land reform and title registration programmes. By placing the decision on land selection and price negotiation in the hands of the beneficiaries the first group of instruments could eliminate several inefficiencies, although their cost could be extremely high. Current land title registration programmes seek to create rural property registers with continuous updating, and to establish systems for evaluating the impact of title registration programmes. These activities promote innovations such as the participation of private offices in the title regularization process via publicly-funded regional bidding competitions; inclusion of new regulations and financial incentives (or penalties) to prevent further subdivision of properties or informal land sales; and the linking of land title registration projects to other agricultural support programmes (transfer of technology, investment and credit programmes).

b) Financial markets

Rural financial markets allow rural residents greater access to financial resources (credit). These markets could be developed by promoting and strengthening viable financial institutions, encouraging the use of non-traditional credit methods, estab-

lishing an efficient regulatory framework and well-defined property rights, creating new guarantee mechanisms, and establishing the means for cooperation between formal and informal lending institutions. Rural areas are largely devoid of financial services, particularly formal credit institutions. This calls for efforts to build a new institutional base that will enable a larger number of rural inhabitants to obtain loans and to become generally "bankable". Specifically, rural financial market programmes could include support for regulatory legislation and its active enforcement and the reduction of production and marketing risks. Reduction of risks can be fostered by promoting insurance, futures markets, and hedging, as well as through the adequate disclosure of information. There are several issues of key importance in the development of financial markets, such as the design of non-traditional credit services tailored to the rural context (group loans in which members are jointly and severally liable, village bank intermediaries, and revolving-fund programmes); innovative means of attracting savings, which are of crucial importance for ensuring the financial sustainability of institutions; and the design of means of cooperation between formal organizations that possess the resources and non-formal ones with the necessary information for the selection and monitoring of clients and recovery of loans. There are various mechanisms available for providing alternative financial services, such as through second-tier banks with revolving funds to support the rural sector, and the option of linking micro-enterprise support projects with local credit services.

c) Development and transfer of new technologies

With a few exceptions, agricultural and natural resource management research and the transfer of technology for improving the productivity of small-farmer agricultural systems have not been high priorities for national agricultural technology systems. More emphasis on applied research is needed, particularly on the adaptation of available technologies to the specific conditions of small producers (lack of machinery, limited access to financing, risk aversion). Most of the financing and in some cases the implementation of these activities, which are necessarily local and public-good type in nature, will continue to be the responsibility of public organizations. Increasingly, technology transfer projects are being carried out by private firms, NGOs and the tech-

nical departments of trade associations, paid for with public funds under contracts awarded on the basis of competitive bids. Along with technology development and transfer, there is a need for the provision of training for small farmers in such matters as methods of financial administration and farm management, recording of costs and financial accounting, statutory requirements and taxes, as well as sustainable management of natural resources.

d) Investment in small-scale irrigation works

Only in a limited number of cases have the large-scale irrigation projects of the past benefited small farmers. By contrast, investments in small-scale irrigation (micro-irrigation) and the introduction of improved technology (drip, mini-spray irrigation) in small farming operations could have very positive results. Converting dryland to irrigated operations has effects on productivity and farm income equivalent to a substantial increase in acreage. In addition, irrigation projects have a significant effect on rural employment.

e) Promotion of new cooperative methods of marketing

Rural economies face high transaction costs when trading on various commodity markets, which explains why those areas with the best market connections are the most developed. Accordingly, more emphasis should be placed on developing rural markets. The weak position of small-scale farmers in their commercial negotiations is a recurring problem, especially when markets are becoming increasingly competitive and require more sophisticated management of information systems. There are several ways in which small producers can gain access to markets: through the creation of price information centres and the provision of negotiation services (including technical advice), the formation of associations to participate in commercial ventures, and the expanded use of contracts with agroindustries.

2. Natural resource-based efforts

It is estimated that the population of Latin America will rise to 670 million by 2020, while the number of rural inhabitants will remain unchanged in absolute terms at about 125 million. The pressure which rural and urban dwellers put on the region's natural re-

sources will go up proportionately. Poor farmers generally do not have the equipment, inputs and technology needed to carry out conservation works or replenish natural resources. Many lack secure access to the land and resources they work, cannot count on reaping the benefits of conservation practices, and therefore have no incentive to protect water, soil and plant resources. Allowing access to natural resources on public or unregistered land without social controls on their use invites deterioration.

Breaking the circle of poverty and deterioration of natural resources can result in a virtuous circle where restoration of natural resources aids in the reduction of poverty, if support programmes are designed with this specific aim in mind. These programmes could include a long-term incentive plan for rural families in the form of a bonus per unit of land taken out of production and included in the programme to restore depleted resources (continuing until such time as the resources are restored), and special loans for investment in and conversion of areas set aside for forestation, combined livestock and forestry operations, introduction of ground cover, or other soil restoration practices. These are medium-term programmes rather than emergency projects for job creation.

Since agriculture cannot provide sustenance for small farmers whose lands are depleted, the corresponding areas and remaining natural resources could be put to other uses such as the conservation of ecosystems and biodiversity and the preservation of natural landscapes which, through their esthetic qualities and wildlife resources, could support recreational activities and income-producing alternatives such as ecotourism linked to the presence of lakes, rivers, parks and nature reserves. In this way, urban society's demand for increased environmental restoration and conservation efforts could be turned into productive activities to increase the incomes of the rural poor.

Some of the elements of sustainable management of natural resources which could be used in rural programmes include: using multiple cropping and conservationist methods that increase yields without depleting soil or water resources, while maintaining or creating employment; legal reforms that promote the rational use and decentralized management of water resources, ensuring equitable access and enforcement of the applicable regulations; watershed

management which strikes a balance between the need for development based on sustainable use of resources and the participation of the rural population; changes in strategies and laws to preserve the natural forests and their biodiversity, together with their potential for use in the production of environmental services, and the promotion of reforestation through medium-scale commercial plantations; incorporation of fresh water fisheries in plans and regulatory frameworks for the management of water resources, accompanied by training and specialization in services to support aquaculture; and greater emphasis on the role of protected natural areas as a key factor in rural development and the sustainable use of resources, with particular attention to the consolidation of national systems of nature reserves, participation by rural communities in the management and rational use of resources, and promotion of sustainable uses of biological resources, as for example in alternative natural products.

3. Rural non-farm activities

All too often in the region, agricultural development instruments have been used with the aim of reducing poverty among rural inhabitants who lack agricultural potential. Because small-scale farmers with less agricultural potential and landless peasants represent a large proportion of the rural poor, rural non-farm economic alternatives are of key importance for reducing poverty in the region. Since an increasing proportion of the rural population works outside agriculture (and a growing number of members of the agricultural labour force live in urban settings) it is especially relevant to focus more attention on rural non-farm issues and on rural-urban linkages. A recent study (Reardon and Berdegue, 1999) shows that on an average in 13 countries, 47% of rural income was originated off the farm. This contradicts the conventional wisdom that tends to equate rural incomes with farm sector incomes (either from wage-employment or from own-account farming). Moreover, rural non-farm employment, which represents 30% of the total (Dirven, 1997), appears to be increasing faster than farm employment.⁴

The fact that migration contributes to the alleviation of rural poverty is a signal that part of the solution lies outside agriculture. It is thus essential to improve the ability of rural inhabitants to enter the labour markets, generate non-agricultural sources of

employment and income, and provide better conditions for those choosing to move to an urban setting. Although agricultural activities will continue to provide the primary means of sustenance for a large proportion of the rural population, efforts should be made to diversify sources of employment in rural areas and upgrade the job skills of rural inhabitants so that they can better compete in urban labour markets which will continue to attract sufficiently qualified members of the rural population. The expansion of employment opportunities should include self-employment in agriculture, fisheries and forestry, small business and handicrafts and must also seek to create wage-paying job opportunities by attracting private-sector employers to rural areas. Also, more attention should be given to support, in the case of farmers who have little land, for on-farm productive activities that are agricultural but do not require much land (small animal husbandry), as well as non-agricultural on-farm activities. Of the various alternative non-farm options, the following section concentrates on micro- and small enterprises, job training, and investment in rural infrastructure.

a) *Development of rural micro-enterprises*

More than half of the jobs in the region are provided by enterprises with less than 10 workers, and 50% of these are family-run businesses. Particularly fast-growing are small businesses owned by women. In order to foster the development of such micro-enterprises, it is essential to create conditions that will enable them to become competitive and independent of outside support, by providing a favourable regulatory framework and policies and by improving the access of low-income groups to financial and commercial services. The development of small and micro-businesses in rural areas can also be aided by efforts to decentralize and improve rural financial services, especially if access to small loans can be increased.

⁴ The main difference between the shares of rural non-farm employment and income therefrom (30% vs. 47%) could be explained (in addition to the different sources and lack of comparability of data) to pluriactivity, in the sense that incomes are earned from various sectoral sources across the year for a given individual and across individuals in a given family. The share of rural households that do not sectorally specialize, and thus are 'pluriactive', can be high (40% in Nicaragua, according to Reardon and Berdegue (1999)), and this is not usually reported in censuses that only ask about the 'primary occupation'.

Certain micro-enterprise activities are particularly well suited to the rural economy: agro-industries, workshops for the repair of machinery, handicraft industries and craft shops, commercial and sport fishing, furniture-making and woodworking industries, and those related to tourism (small restaurants and hotels, thermal spa facilities, cultural sites). The rural sector offers great potential for the processing of natural materials into diverse articles and handicrafts, including wooden products, medicinal plants, fibres, fruits and nuts, flowers, and semi-precious stones, all of which can encourage the sustainable use of these resources.

b) Job training to improve employment opportunities and incomes

Since primary and secondary education are seen as determinants of both job placement and income levels, the demand for access to these services is very high among the rural population. Again, this is a key area on which governments should concentrate to ensure a basic level of formal education in rural zones. In many of the region's countries, however, the vocational training available has not taken account of the specialization and skills demanded by markets. For example, in many cases the number of agricultural training programmes provided for young people far outstrips the potential number of future jobs in the sector. The objective here should be to improve opportunities for both men and women among the rural poor, providing them with technical skills that match labour requirements in urban and rural areas alike, including training to equip them for self-employ-

ment. Vocational training programmes such as combined work and study programmes operated in cooperation with private companies are very efficient in doing this.

c) Attracting public and private investment in infrastructure

Public and private investment enjoying tax and other financial incentives (such as the creation of industrial parks with public incentives for private industry to locate in rural areas), land distribution, reforestation and irrigation projects, rural electrification, tourism and other schemes put in place to channel investment to rural zones can have a powerful job creation effect benefiting the rural poor.

It is particularly important to correct regional imbalances (between urban and rural areas and also within rural areas themselves) and promote regions that have, for instance, good natural resource potential. In this respect, investment in roads is a powerful means of attracting outside investment for marginalized rural areas, while at the same time enabling services to reach the lowest-income groups and reducing the transaction costs involved in the marketing of rural production. The lack of all-weather roads is a severe drawback in efforts to attract private sector investment to rural industry, mining and tourism. Investment in rural road infrastructure, in addition to its positive impact on local employment in the construction industry, improves access to social services, reduces commercial transaction costs, opens new labour markets, and generates externalities that benefit the rural poor.

VI

Conclusions

In spite of the substantial period of economic growth in most countries of Latin America and the Caribbean registered during the past decade, rural poverty has not decreased significantly. Indeed, the number of rural people living in poverty actually increased between 1994 and 1997. In addition, urban poverty is also fueled by the migration of the rural poor to the cities. The rural setting in Latin America and the Caribbean is very diverse, increasingly linked with urban settings and with a

relatively sparse population. There are also great variations in the nature and magnitude of poverty conditions in rural areas. Although agriculture is still the main source of employment, rural non-farm activities are increasingly significant and quite interdependent with urban centres. Given the broader, interconnected and multisectoral elements involved, rural economic and social issues should be viewed from a territorial rather than an exclusively sectoral standpoint.

On top of the many differences in culture, rural geography and natural resource endowment, and institutional and political context that distinguish the various countries of the region, there are also myriad regional and micro-regional differences within each country. This great diversity in rural conditions has several implications for choosing among rural development approaches: for multilateral agencies, it points to the need for continuous and open dialogue with each country to define and shape projects for specific issues; for individual countries, it means a strong commitment to decentralization to accommodate diversity and encourage the various actors to express their opinions; for the region or micro-region in which the activities will be implemented, it calls for great flexibility, to ensure that this implementation is consistent with the possibilities and interests of the inhabitants; and at the community level, it means that the approach chosen must encourage the participation of all beneficiaries and cooperating organizations (NGOs, community groups, government agencies, municipalities) in the design, execution and evaluation phases of rural initiatives.

A special focus on rural development (to reduce the urban bias) can help to make up for the cumulative shortfall built up in the past in social expenditure and spending on rural infrastructure. This will require making good the gap in training programmes, establishing basic rural infrastructure to provide an incentive for private investment, and providing the rural poor with access to the services and markets available to the urban population. It is important that these measures be transparent and targeted on the poorest segments, avoiding an indiscriminate general transfer of resources. In addition, linking economic growth to poverty reduction in rural areas requires mechanisms to ensure that the benefits of growth reach those who lack the leverage necessary to obtain access to them: particularly the most vulnerable groups such as young people, women and indigenous communities.

There is evidence that rural non-farm activities are an increasingly important source of income for farm and other rural households, including landless peasants and rural town residents. In spite of this trend, most rural poverty alleviation efforts have not taken full advantage of employment opportunities

generated by wage-earning or self-employed activities such as commerce, manufacturing and other services. The rural non-farm economy's links with input and output markets as well as services are key variables for defining rural policies in the region, particularly in small and micro-rural enterprise development, such as small craft industries, small agro-industries (of increasing importance in the rural economy) and services related to the agricultural sector or to other activities (tourism, for example).

Equally useful in terms of providing employment for the rural poor, as well as for environmental purposes, are other investment initiatives based on natural resources, such as reforestation, soil conservation, watershed management, and the creation and management of national parks and reserves. Agriculture-based options constitute a third key alternative for reducing rural poverty in the region; they include the development of land, water and financial markets, investments in new technologies and irrigation, and the promotion of new methods of marketing.

Of the several possible options for reducing rural poverty in the region, five are of crucial importance: (i) migration to urban areas where there is a greater demand for labour, which has been the traditional option but could be improved by providing training to prepare migrants to secure urban-based jobs; (ii) social safety nets (welfare) for the population who do not have rural or agricultural production potential but cannot migrate for reasons of health, age, etc.; (iii) rural non-farm activities; (iv) natural resource-based efforts (recovery and conservation of natural resources); and (v) agriculture-based activities for small-scale farmers who do possess agricultural potential. In reality, two or more of these options can be combined, so that, for instance, a small-scale farmer with limited agricultural potential may have several off-farm economic activities to diversify his income, while rural inhabitants with no access to land can diversify their income by working on farms. Given the critical poverty situation in rural areas, migration and social welfare will probably continue to be among the most important alternatives. Significant investments in sustainable agriculture development and rural non-farm economic activities are required in order to achieve the necessary economic growth and rural poverty reduction.

(Original: English)

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Equity in education *in El Salvador*

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In terms of equity of educational opportunities, the region displays great problems, and El Salvador is no exception to this. The analysis given here of the shortcomings in respect of equity of education in that country begins with a general description of the fundamental lines of action proposed in the educational reform process. A study is then made of the differences in access to education, the intergenerational transmission of educational opportunities, and disparities in the quality of education. It is noted that education has an instrumental function –economic reproduction– but it also has a function of promoting change in pursuit of a more equitable society. It is asserted that the contribution education can make to development has its limits, and the effect of poverty on educational opportunities and hence on individuals' real possibilities of getting on in the world is highlighted. Finally, some ideas are put forward for maximizing the contribution of education to the development of El Salvador.

I

Introduction

This article seeks to make a contribution to the consideration of the subject of education and development in El Salvador, in the light of the unequal opportunities offered to social sectors of different economic and social levels. This subject has important ideological and practical implications when considering Salvadorian education and may also be useful for other Latin American countries with similar characteristics, for the problem of educational inequity analysed here in detail coincides in many respects with the situation of most other Latin American countries. The decisive connection which exists between economic and social inequity and educational inequity reveals the current limitations on the

contribution that education can make to growth, development and overcoming poverty. The recognition of this connection is also a first step towards rediscovering the role that education can play in society as an agent of change.

In this study, data from El Salvador are used to analyse, from the point of view of equity, aspects relating to the coverage, quality and intergenerational transmission of educational opportunities. The analysis shows the magnitude of the problem and prompts reflection on the limits of the contribution that education can make to development in the present conditions. Finally, the article puts forward some ideas for helping to maximize that contribution.

II

The role of education and the problem of equity

From the prevailing standpoint of human and economic development, the various levels of formal education generally tend to be viewed as a fundamental mechanism for promoting the emergence of the new productive individuals needed by the present economic model.

Although partly in agreement with the grounds for the relation between education and development, the position taken in this article is one which conceives education in a broader dimension. It cannot be understood solely as the mechanism for ensuring the reproduction of an economic order which, although generally accepted today as the most functional one, falls far short of achieving a society free from pov-

erty and other social scourges. There is no suggestion, however, that the neoliberal model is totally incapable of furthering social development: it is viewed rather as the culmination of a long historical and political process, which can serve as the starting point for achieving a society with higher levels of social justice.

In this view, education must not be seen as a purely reproductive mechanism but rather primarily as a power for change. Education in Latin America cannot be divorced from the quest for innovations and alternatives which can help to improve the way societies operate at present. Education is not a product of the market: the education provided by the State represents a social advance which seeks to provide possibilities for all the inhabitants of the State to progress and for society to develop in the direction chosen by its members, rather than a single direction that cannot be questioned.

If education is defined solely insofar as it relates to the economy, it is reduced to the status of a mere

□ A more extensive version of this study was originally prepared for presentation at the 1998 meeting of the Latin American Studies Association held in Chicago. The author wishes to thank Patricia Craig, Irene Flores, David Bronkema and Alberto Barillas for their valuable comments on the present text.

instrument, so that the whole question simply becomes how much education, of what type, is needed for economic development and for overcoming poverty. This view, which is at once necessary yet partial, ignores the fact that education is a human right by virtue of which people can reach dimensions of the outside and inside world that will help to bring out their personal potential, and that the educational level of the population is in itself one of the indices of the human development of a nation.

When education is reduced to the level of a mere instrument, there is a risk that it will be stripped of its political and moral elements in favour of the noble cause of economic development. Naturally, under this view the instrument serves to reproduce the model, and if the model is assumed to be just and to ensure development and the elimination of poverty, then the fact of reducing education to the level of an instrument does not offer any problems. If it is assumed that the economic model is not perfect, however, then taking a totally neutral attitude to education is dangerous, because no questions are asked about the grounds and reasons for education. Education does in fact serve political ends, and we must ask ourselves: what should those ends be? A great deal of emphasis has been placed on the need for education to further the principle of productivity, and although in this article we do not deny the importance of this aspect, our proposal is that education should also serve the principles of justice and solidarity. As the data show, social and educational conditions in the Latin American countries, and especially in El Salvador, are profoundly inequitable. Consequently, education should aim at promoting changes in our forms of social coexistence in order to make them more harmonious and solidary.

In Latin America,¹ the distribution of wealth can serve as a starting-point for analysing the problem of equity. Thus, for example, in 1994 39% of the population of the region as a whole were in a state of poverty and 17% were in a situation of extreme poverty. In El Salvador, however, the situation is much more serious, because in 1997 52% of the population were below the poverty line and 22% were in a state of extreme poverty (El Salvador, Dirección General de Estadísticas y Censos, 1998).

In addition to the problem of poverty, the region suffers from unequal distribution of wealth among the population. Although there appears to have been a modest trend towards the reduction of poverty in the first half of the 1990s, there have been few changes in income concentration, even in the countries with the highest economic growth rates and the lowest levels of poverty (ECLAC, 1997a, p. 21). This is also the case in El Salvador, where there was no change in income distribution between 1992 and 1995, as reflected in the Gini coefficient of 0.5 for those years (IDB, 1998). These levels make El Salvador one of the Latin American countries with the biggest disparities in income distribution (see comparative data in ECLAC, 1997b, p. 46). Likewise, other indicators show that there is unequal distribution of human development in El Salvador, with the poorest sectors registering less progress than the richest sectors (UNDP, 1997, p. 23).

If we center our analysis on educational aspects, we see that the efforts made over the last 10-15 years to expand the coverage of education have not been reflected in a narrowing of the gaps between the different social strata. According to data for the 1980s and first half of the 1990s on the urban areas of 11 Latin American countries, the differences in the proportions of young people between 20 and 24 years of age with 12 years' schooling from households with different levels of educational capital remained practically unchanged over this period.

Other data indicate that in the countries of the region between 30% and 45% of all households can be classified as being vulnerable to poverty, while only 10% of the households possess most of the economic and educational capital. Of the total number of young people between 20 and 24 years of age coming from households that are vulnerable to poverty, 80% are lagging behind at school or have dropped out altogether, whereas less than 40% of young people from households with economic and educational capital are in this situation.

Quite apart from the inequalities in terms of access to education and number of years of schooling, the educational differences between students from different economic and social levels become still more marked when the unequal quality of the education received is taken into account. A quantitative indicator which can be used as an approximation to the quality of education is the performance in standardized learning tests. The regional-level data register

¹ The information given in this section is based on ECLAC, 1998.

big disparities between the public and private sectors: whereas most students in the public sector only manage to successfully cover some 50% of the official curriculum, the average for students enrolled in private schools is close to 100% (ECLAC, 1998, p. 70). In Chile, which was one of the countries with the highest economic growth rate in the 1990s and has one of the highest levels of years of schooling, learning tests have shown that the most important factor affecting educational performance is the economic and social level of the students' families (PIIE/UNICEF, 1995).

Furthermore, social mobility has long been linked with the opportunity to gain access to more and better education. This link, which is indisputable in theory, runs into serious obstacles in reality, one of the most important of which is the very situation of poverty which it is desired to overcome.

In Latin America, the average number of years of schooling has been raised generation by generation. Only a small proportion of young people, however, manage to rise significantly above the educational level of their parents. Thus, while on average young people have three years more schooling

than their parents, only a third of urban young people and one-tenth of rural youth have managed to exceed the educational level of their parents and attain a level of basic educational capital equal to 12 years' schooling (ECLAC, 1998, p. 60). Of the total, 47% of urban young people and 73% of rural youth neither exceed the educational level of their parents nor reach the basic educational target level.²

The figures bearing witness to the inter-generational transition in terms of opportunities are also reflected in the opinions of those consulted on this matter. Some data from Chile, for example, seem to show that the views of the parents interviewed regarding the probable future of their children are influenced to a large extent by the quality of the school they attend, which largely depends on the possibility of going to a paid private school (UNDP, 1998, p. 179).

To sum up: "The persistent lack of equity in terms of access to education based on social background shows that, to a large extent, opportunities for well-being are shaped by the pattern of inequality that prevailed in the previous generation" (ECLAC, 1998, p. 65).

III

The educational reform process in El Salvador and policies on equity

Now that the Latin American context has been outlined, the analysis will center on the particular case of El Salvador, which, as we shall see, displays tendencies similar to those of the region as a whole. In the past, there has been an endemic situation of social inequity in that country, which was one of the main causes of the civil war of the 1980s. The peace accords were achieved when efforts were made to put an end to violence and transform Salvadorian society through the creation of democratic institutions and juster living conditions for the mass of the population. On the educational level, that country's experience in carrying out reforms is particularly interesting because it has received substantial international support and has made efforts to match the development and educational models prevailing in international circles.

In 1993, Harvard University, the "José Simeón Cañas" Central American University (UCA) and the Salvadorian Educational Development Foundation (FEPADE) made a diagnostic study of the educational sector which marked the beginning of a process of dialogue and reflection in the country on the need to reform the educational system. The study showed the profound shortcomings of the existing system in

² According to ECLAC calculations (ECLAC, 1997b, p. 66), an analysis of the qualifications of those entering the labour market in the region shows that, at present, completing the secondary cycle and having at least 12 years' schooling is a basic requirement for securing a reasonable level of well-being. In a large number of countries the data show that reaching this educational threshold gives a likelihood of over 80% that the individuals in question will be able to obtain an income that will allow them to rise above the poverty line.

terms of access and quality at all levels, as well as the inadequacy of the public resources set aside for the educational sector and the poor management of the resources available. It also showed the need to revise and reformulate both the legislation on education and the arrangements for training teachers. In short, the report expressed the urgent need to make radical changes in most areas and levels of the formal educational system.

On the basis of the findings of the UCA/Harvard/FEPADE study, the Ministry of Education organized a process of consultation with the different sectors of society. It set up the Commission on Education, Science and Development to set forth guidelines for the transformation of education in the country. It also carried out extensive consultations with different organizations through the National Consultative Forum on Educational Reform. The "Consulta '95", designed to collect the views of teachers, parents and students, and the technical experts of the Ministry of Education, together with the consultation of "ANDES 21 de Junio" (the most important professional association of teachers in the country), were other consultation processes that served as a basis for the preparation of the reforms.

With the important background information described above, the Ministry of Education put forward a programme of reforms in what it called the 1995-2005 Ten-Year Plan. The objectives stated in this document are: to improve the quality of education at all its levels; to increase the efficiency, effi-

cacy and equity of the educational system; to democratize education; to create new ways of providing services, and to strengthen the formation of human and civic values. The concrete goals set for the decade were: to reduce the rates of illiteracy, teacher absenteeism, and dropping out and repeating courses by students; to increase the coverage of educational services; to involve the educational community in the management of education; to use State resources efficiently, and to provide timely solutions for the problems of educational establishments.

The measures through which the reform programme tries to tackle the specific problem of inequity are: establishment of the Programme of Healthy Schools and the programme for Education with Community Participation (EDUCO); use of the World Food Programme; the Alternative Classrooms programme, and expansion of the school infrastructure and distance education.

In El Salvador, the measures to expand coverage have given priority to rural and poor areas. As a result, coverage has increased at all levels of the lower educational system, but especially in pre-school and basic education.

Among the measures to improve the quality of education, special mention may be made of the Programme of Healthy Schools and the EDUCO programme, because they are based on the principle of positive discrimination. The rest of the measures in the field of the quality of education have applied to all schools more or less equally.

IV

Equity in education in El Salvador

In spite of the action taken by the Ministry of Education under the educational reform programme to reduce educational differences in society, there is still an enormous amount of inequity between the different social sectors. Consequently, the first thing to do when considering the measures which have been undertaken and the need for new strategies to overcome the present situation is to recognize the dramatic insufficiency of the efforts made so far (in spite of the substantial achievements in recent years and the fact that they are indeed on the right track), together with

the similarity of the situation in El Salvador, in terms of equity, to that of most other Latin American countries.

1. Equity of access

The educational situation of the population, as measured by the number of years of schooling, is pretty poor. According to data for 1996 (table 1), 58% of the population aged six or more have five years' schooling or less, while only 6.1% have over 12

TABLE 1

**El Salvador: Distribution of the population aged 6 or more,
by number of years of schooling, 1996**
(Percentages)

Number of years of schooling	Total	Quartiles by level of income			
		1 st quartile	2 nd quartile	3 rd quartile	4 th quartile
0-5 years	58.0	32.9	28.6	24.2	14.2
6-9 years	24.1	14.9	23.1	31.7	30.3
10-12 years	11.7	5.3	12.8	29.7	52.3
Over 12 years	6.1	2.7	4.7	15.0	77.5
Others ^a	0.0	47.4	52.6	-	-

Source: El Salvador, Dirección General de Estadísticas y Censos (1997).

^a Includes the categories "special education" and "not known".

TABLE 2

**El Salvador: Proportion of children attending school,
by age and income group, 1991 and 1996**
(Percentages)

Age	5 years		6 years		7 years		13 years		14 years		15 years	
	1991	1996	1991	1996	1991	1996	1991	1996	1991	1996	1991	1996
1 st quintile	16	33	30	47	55	70	64	74	53	65	45	53
2 nd quintile	20	37	38	54	62	79	70	82	59	67	52	56
3 rd quintile	36	48	54	65	71	80	74	78	72	74	58	68
4 th quintile	53	64	74	83	84	88	86	85	74	82	70	72
9 th decile	69	83	83	93	90	95	89	90	79	85	81	84
10 th decile	74	93	85	93	91	100	90	98	87	98	82	94

Source: Reimers (ed.) (1995), p. 71, and El Salvador, Dirección General de Estadísticas y Censos (1997).

years' schooling. Furthermore, the amount of schooling is unequally distributed, depending on people's income levels.

Of the people with five years' schooling or less, 14% are in the top income quartile and 32.9% (i.e., twice as many) in the bottom quartile (table 1). If the analysis is by deciles, we find that only 4% of the people in the richest decile have five years' schooling or less, whereas 14% of the people in the poorest decile are in that situation. Moreover, the differences are still greater in the case of people with over twelve years' schooling: only 2.7% of the people in the poorest decile reach that level of education, whereas 77.5% of the people in the richest decile have access to post-secondary studies.

For the same year, data on the pre-school and school population (4-18 years of age) show that 69% of that group are attending school, but here too the

distribution is unequal, depending on income. In the poorest quintile, 59% receive some kind of education, whereas in the richest decile the corresponding figure is 89% (El Salvador, Dirección General de Estadísticas y Censos, 1997).

In a more detailed analysis of inequalities in access to education as a function of household income (table 2), some specific age groups are taken and their evolution over five years is compared (between 1991 and 1996). The data for 1996 show that nine out of ten children aged 5 from the richest homes are attending school, most likely in pre-school education, whereas only three out of ten of the children from the poorest quintile are able to do so. In the case of adolescents aged 15, the proportion remains practically the same for those from the richest decile, while there is a slight increase in the case of those from the poorest quintile, since four out of five are going to school.

We can also see that access to education has increased for almost all the age groups and income levels considered. The increase is bigger for the 5, 6 and 7-year age groups and for the first two income quintiles and the tenth decile, thus mostly favouring the poorest children, especially those of pre-school age and those starting in the official school system. There has also been a substantial increase in the case of children from the richest decile, but here the increase was most marked for children of 5, 14 and 15 years of age. There have been noteworthy advances in access to basic education since 1991: in the richest sectors they have been most marked in the age groups corresponding to the last grades of basic education, while in the poorest sectors the effect has been most noticeable in the age groups corresponding to pre-school education and the first grades of primary education.

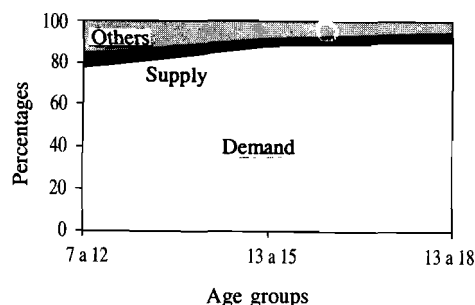
Between 1991 and 1996, the gap between the first income quintile and the tenth decile in terms of the access of 7 year old children to education has narrowed from 36% to 30%, indicating that the progress has been greatest in the case of the poorest groups, thus reducing the level of inequality, but the gap increases steadily with age, amounting to 41% for the 15 year old age group. This is partly due to the fact that the measures taken by the Ministry of Education to expand coverage have been aimed primarily at the first basic education cycle (grades 1 to 6). Indeed, the analysis of the evolution of enrollment given by that Ministry shows significant advances in coverage at the basic level, but less impressive achievements in secondary education (Carrasco and Fernández, forthcoming).

Inequalities in access to education also depend on whether the area of residence is urban or rural. For the total population between 7 and 18 years of age, the level of access to education is 74%, but analysis by areas of residence shows that while 83% of young people of all ages from urban homes attend school, the corresponding figure for rural areas is only 66%. Furthermore, as in the case of the comparison by income brackets, the differences between urban and rural areas are greater in the final years of the 7-18 age group: the system becomes more inequitable as the age and school grades of the students rise (FEPADE, 1997).

The disparities are maintained at the higher levels of the educational system. Thus, in 1996, out of every 100 young people in the second year of secondary education, 40 came from the richest decile

FIGURE 1

El Salvador: Link between supply/demand for education and reasons for not studying, by age groups



Source: FEPADE (1998), p. 76.

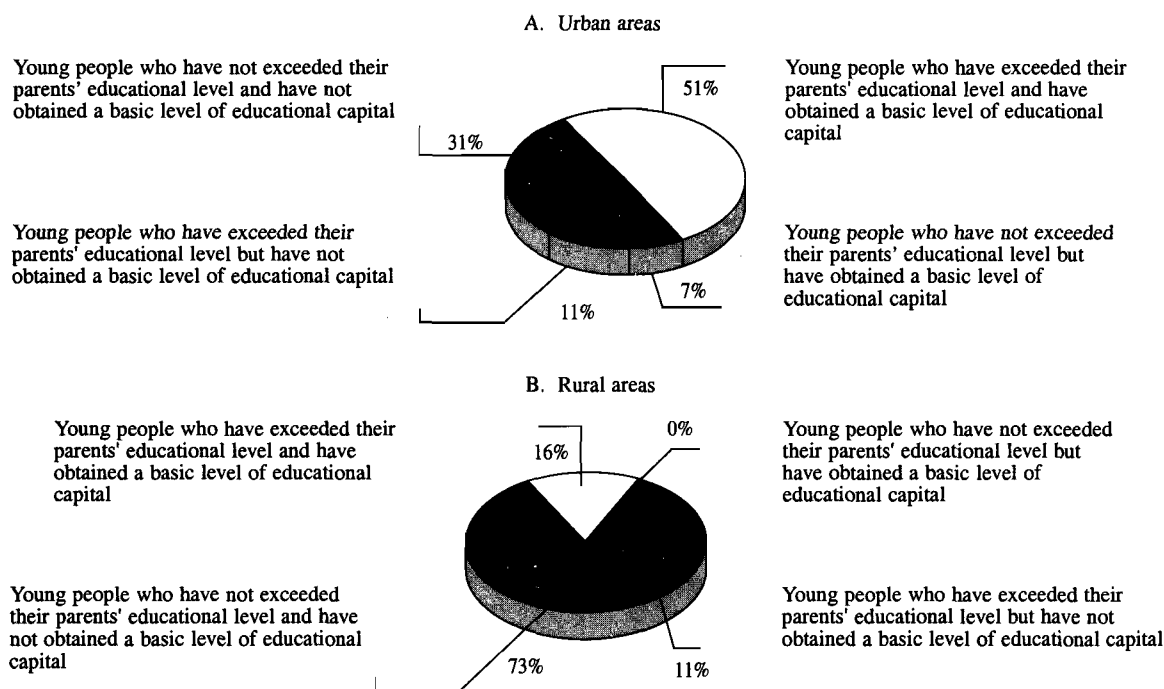
but only 10 came from the poorest decile. Among those who report that they are in their first year of university studies, only 2.5% come from the poorest quartile, whereas 62% come from the richest quartile. Of all university students, only 2% come from the poorest quintile, while 30% come from the richest decile: these figures are not significantly different from those for 1991, when the respective percentages were 2.35% and 31.67% (Reimers, ed., 1995, p. 72).

With regard to differences by sex, the educational situation of women appears to be unfavourable when the total population is considered, for this includes segments resulting from previous educational systems which strongly discriminated against women. In the present educational system, however, the situation of young women and girls is equitable as compared with that of males. According to data extending up to 1995, whereas in the over-60 age group there were 36% more women than men who had not completed any school grade at all, in the 6-9 age group the difference between the sexes was only 1%, and moreover favoured the female population (Carrasco and Fernández, forthcoming). This equality between the sexes was also observed in the figures on illiteracy and on the percentage of persons of different ages attending school (FEPADE, 1997).

When seeking reasons for the differences in access to education between the different sectors of the population, as classified by income and area of residence, one instinctively thinks of poverty as the explanation. This is backed up by the data collected (El Salvador, Dirección General de Estadísticas y Censos, 1997), as the four reasons for not studying most frequently given by those interviewed were, in order of importance, "high cost" (lack of economic

FIGURE 2

El Salvador: Educational achievements of young people between 20 and 24 years of age compared with those of their parents, 1996



Source: El Salvador, Dirección General de Estadísticas y Censos (1997).

resources), “need to go to work”, “household reasons” and “not worth the trouble”. These four reasons are connected with the unfulfilled needs of the population. The answers given indicate that the reasons for not studying are basically connected with the lack of demand rather than the nature and structure of the supply of education. Moreover, the arguments relating to supply are more frequent in the case of the lowest age groups, and as the age of those interviewed rises they relate increasingly to the lack of demand (FEPADE, 1998, p. 76).

According to an opinion survey carried out by the UCA in 1997, 19% of those under 19 years of age were not studying: 46% of those interviewed explained this situation on the grounds that they did not have the necessary money or resources; 28% said that the young people concerned did not study because they had to work (including domestic work); 18% said they had no desire to study, and 7% gave various other answers. These data show that for 73% of those interviewed the main cause limiting their access to schooling was poverty.

2. The inter-generational transmission of educational opportunities in El Salvador³

According to data for 1997, young people between 20 and 24 years of age have an average of 4.7 more years of schooling than their parents: the average schooling of the parents is 4.2 years, while that of their children is 8.9 years. In urban areas, the increase is 5 years (6 years' schooling for the parents and 11 years for their children), and there has also been an increase (albeit smaller) in rural areas, from an average of 2 years' schooling for the parents to an average of 5.8 years for their children aged between 20 and 24. This shows that although both sectors have registered progress, the increase has been greater in urban areas, so that the differences compared with rural areas have increased still further.

³ The procedure for calculating the extent to which young people exceed the education level of their parents was effected by replicating the model developed by ECLAC (1998, p. 61).

The average increase in the number of years of schooling is naturally due to the contribution of the 49% of young people who have managed to surpass the educational level of their parents, since the remaining 51% failed to do so. Within these two categories, it is also important to determine what percentage of the population of El Salvador have managed to rise above the basic educational threshold that increases their likelihood of earning sufficient income to live decently. In this respect, we find that only 4.4% of the population between 20 and 24 years of age, although failing to exceed the educational level of their parents, nevertheless managed to study for 12 years or more. In contrast, 46% of young people neither exceeded the level of their parents nor reached the threshold level of basic education needed to provide a reasonable level of well-being. Only 36.6% of young people manage to exceed the educational level of their parents and also acquire the necessary basic educational capital: only they will have a chance of upward social mobility on the basis of their educational capital; 12.7% exceed the educational level of their parents, but not by a sufficient margin to obtain even 12 years' schooling.

The situation is also inequitable as between urban and rural areas. In urban areas, 51% of the young people manage to exceed the educational level of their parents and also complete 12 or more years' schooling, whereas only 16% of rural young people do so (figure 2). Furthermore, 73% of rural young people neither exceed the educational level of their parents nor complete 12 years' schooling, while a further 11%, although they exceed their parents' educational levels, do not manage to acquire the necessary basic educational capital.

The data thus indicate that in El Salvador there is only a low level of inter-generational educational improvement, especially in the poor sectors of society. For much of the population, there are few possibilities of exceeding the educational levels of their parents and obtaining sufficient educational capital to enable them to attain a better level of living. The educational achievements of the new generations in terms of number of years of schooling are determined to a large extent by the pattern of inequalities of the preceding generation.

3. Equity as regards quality of education

For a large number of people, their chances of improving their level of living are limited by their scant

possibilities of attending school. Despite persistent problems of equity, however, the educational system is nevertheless tending to increase its coverage. Although the task of providing access to education is still an enormous challenge for society, the question of the quality of the education provided is also of special interest to those who, having gained access to the school system, hope to receive an education which is sufficiently good to allow them to improve on the living conditions of their families of origin. In El Salvador the differences in the quality of education are enormous, as shown by the results of the performance and repetition tests given below.

a) *Differences in performance in the Learning Achievement Tests*

One of the measures taken in conjunction with the preparation of the new curriculum was the development of Learning Achievement Tests and their application since 1993 to a sample of pupils from the third and fifth grades. These tests evaluate on a points basis the degree of fulfillment of the objectives of the official programmes. In mathematics, the maximum number of points is 10, and in language, 9.

According to data for 1994 and 1995, even in the best of cases the average third and fifth grade pupils in the country's schools had not fulfilled even 40% of the learning targets in language and mathematics. Complementary comparative analyses revealed that pupils in urban areas had a slightly better average than in rural areas, while the performance of the pupils of EDUCO schools was even worse than that of the pupils of non-EDUCO rural schools (El Salvador, Ministerio de Educación, 1996).

Of course, the performance of the students, like their access to education, varies according to their families' income. Thus, for example, the comparisons between public and private schools also reflect the tendencies observed in other countries. In mathematics, the average for students in private schools is 2.15 points higher than in public schools, while in language the private schools are 1.5 points higher.⁴

⁴ The difference in measurements is statistically significant in the case of both subjects. The Statistical Package for Social Sciences (SPSS) gave a result of $P=0.000$. These analyses were made with information taken from the data base of the Learning Achievement Tests applied in 1996.

Finally, a study carried out by professionals of the Ministry of Education and FEPADE (FEPADE/El Salvador, Ministerio de Educación, 1998) examined the factors influencing the performance in Learning Achievement Tests, using multiple regression analysis. The model included a set of factors alterable by actions of the educational system and a group of factors not directly alterable by immediate actions of the system. Among the variables were teaching experience, the educational level of the teacher, an economic indicator of the family, and an indicator of the level of development of the municipality (an indicator of the unsatisfied basic needs in the municipality). The language model had a value of $R^2 = 0.28$ and the model for mathematics had a value of $R^2 = 0.30$.⁵ According to this regression analysis, students in private schools tend to obtain 0.33 points more than those in public schools in language and 4.0 points more in mathematics. Furthermore, it can be calculated from the results of the regression analysis that in mathematics, students from one of the poorest municipalities (with the largest number of unsatisfied basic needs) obtain 3.02 points less than students from one of the richest municipalities.

The study in question concludes that "in both subjects the indicators which individually help most to explain the performance in the Learning Achievement Tests were those related with the social, economic and cultural conditions of the populations attending those schools (sector and area where school is located, economic and social conditions of the students' families, level of poverty of the municipality in which the school is located). Students from families of lower economic and social levels, attending public-sector schools in the poorer municipalities, are at a disadvantage in terms of performance" (FEPADE/El Salvador, Ministerio de Educación, 1998, p. 2).

These data indicate that in general, as measured by the present learning achievement tests, the performance of Salvadorian students is very poor. They also show that, as in most Latin American countries, the performance of the poorest students is much lower than that of students in a better economic and social situation. Students from the upper economic and social strata learn more and are thus better prepared to take advantage of secondary and tertiary ed-

ucational opportunities and perform well in their working life in the future.

The views of the population bear out the foregoing analyses, because while 54% of those in the upper economic and social strata say that they are very satisfied with the education received by the minors living in their households, only 30% of those in the marginal sectors express the same degree of satisfaction. Moreover, 44% of all those interviewed believe that private education is better than public, while the opposite opinion is held by only 28% (IUDOP/UCA, 1997).

b) *Repetition of grades*

Another indicator which is frequently used to measure the quality of education is the rate of repetition. According to the Multi-Purpose Household Survey, in 1996 8.8% of all students of school age were repeating grades. Here, too, however the distribution was unequal (table 3). Thus, for students from the first quintile the rate of repetition was 13.2%, but this rate went down steadily from one quintile to the next until, in the richest quintile, only 3.9% of the students were repeating grades.

The analysis by area of residence also showed inequality, since in rural areas 12% of students were repeating, whereas in urban areas only 6.3% were doing so. Likewise, the rate of repetition in private schools was 5.1%, but in public schools it was 9.8%.

If we analyse repetition by sex, we find that boys repeat grades more than girls: 9.7% compared with 7.9%. Thus, as in the case of access to schooling, girls were not in a more unfavourable situation than boys.

TABLE 3

El Salvador: Number of students repeating grades, by income groups, 1996
(Percentages)

Income group	Percentage repeating grade
First quintile	13.2
Second quintile	11.1
Third quintile	8.1
Fourth quintile	6.5
Ninth decile	4.4
Tenth decile	3.9

Source: El Salvador, Dirección General de Estadísticas y Censos (1997).

⁵ Both models are statistically significant: $F = 0.000$.

The data show that it is the poorest children who have most difficulty in fulfilling the minimum learning requirements set by schools for moving children up to the next grade. Generally speaking, in absolute terms the requirements of the public schools in this respect are lower than those of private schools, but even so the rate of repetition is higher. This appears to indicate that the poorest parents and public schools have fewer resources for coping with learning difficulties among their children, so that the latter register higher rates of repetition, take longer to complete their basic education and are more likely to drop out altogether, so that there is greater waste of resources by the family and the State on children who repeat grades. In contrast, children from better-off families have less difficulty in completing their studies, do so in a shorter time, and waste fewer resources.

c) *Teaching practices*

A study made by the Training Programme for Educational Researchers (PROFINE) in 1997 (PROFINE, 1997) analysed the teaching practices used in the classrooms of 140 public schools, and it was found that most of the teaching practices that still prevail in the classroom place the teacher at the centre of the teaching process. Moreover, although some group work and play practices were observed which represent incipient efforts to comply with the recommendations of the educational reform programme, there was a lack of the theoretical knowledge, technical and practical skills and sense of the significance of teaching needed to put into practice what was sought for in the reform programme. Repetitive activities based on rote learning still predominate, and the requirements are very low.

The study revealed that teaching practices are still far below those that are desirable, so that it is essential to raise the professional level of the teachers and give the schools greater freedom to seek and pro-

mote new forms of ongoing professional development.

Unfortunately, the coverage of the study did not permit a comparison of the practices in public schools with those in private educational establishments. It is not possible, therefore, to argue that differences in teaching practices are partly responsible for the differences in performance between students from different economic and social sectors. It can, however, be stated that in the public sector very little is done to promote a form of education which develops the skills demanded by the social and productive sectors. Although there has been some progress, especially at the normative level, the practices used are still very traditional. Indeed, the actions taken by the Ministry of Education to improve teaching have had a much smaller impact than expected. For example, the training given to teachers seems to have done little to change their teaching practices and their pedagogical basis: the books and libraries that now exist are used mainly for the children to copy the texts into their exercise books. The new curriculum is being applied, but without grasping the true sense of the methods proposed.

In addition to these weaknesses in the public schools there are also others that greatly widen the gap with the private schools. Thus, for example, access to computers by pupils in the basic and intermediate levels is still only a dream in the public sector, whereas it has been a reality for several years past in many private schools. Nor is access to Internet a real possibility for students or teachers in the public sector. Laboratories which can foster an interest in the sciences and scientific knowledge are scarce even in the universities, and of course even more so in public basic and intermediate schools. Nor is learning a second language feasible in a public school, whereas in many private schools students graduate knowing a second language and in some cases even a third.

V

The limits of education, and ways of maximizing the contribution it can make

In the 1990s, El Salvador set about the reconstruction of the country. One of the main actions taken in the social field has been the educational reform programme, which began by seeking to strengthen the first grades of the educational system and has gradually been extending to the upper levels. One of the main achievements of this process has been that it has made the nation as a whole aware of the need to improve educational conditions. Now, after several years, the reform process has been reflected in some important achievements. Thus, the coverage of the educational system has been steadily and substantially increased, with a positive bias in favour of the poorest sectors. In spite of the advances which have been made, however, there are still serious limitations on access to the system (above all to pre-school, secondary and higher education), especially for poorer persons. Measures have also been taken to improve the quality of education, but their impact has been less than hoped for, and because of the great problems existing in the educational system and society as a whole, there is still a long way to go in this respect.

Education is seen as one of the main strategies for changing production patterns and securing sufficiently high and sustained growth to allow the population to overcome poverty and obtain better living conditions. However, the poverty of many families largely limits their educational opportunities. Education can only help the country to attain higher levels of development if the population is able to receive a good education regardless of their economic situation. The idea is to generate conditions that will allow all sectors of society to have equal educational opportunities, but that is not the case at present.

The country is still far from maximizing the contribution that education could make to development. Even if the educational system were to expand its coverage to the point where there are enough schools and teachers, and even if the education provided in school were of the highest quality, many children still would not be able to attend school, because their

families are poor. Even though education is free, a good percentage of families in the country are hard put to it to generate the income needed to satisfy their basic needs. In the poorest sectors, children who do not attend school do not do so only because of the lack of suitable educational possibilities, but because they need to earn money in order to survive, while other children, although they do manage to attend school, do not enjoy the same backing as children in a better economic situation, so that they gain less advantage from their schooling and their performance is also lower. In the hypothetical case that the educational system were capable of ensuring that all children went to school, regardless of their economic background, there would still be the problem of the enormous gap between the quality of the education received by poor and better-off children, respectively, as well as the disparity between their capacity to take advantage of their learning opportunities.

The educational system faces the challenge of improving the way it operates: that is to say, expanding its coverage and improving its quality, appropriateness and efficiency, while constantly pursuing criteria of equity. From the point of view of development, this would help considerably to ensure growth and progress. However, the contribution that education can make to development does have its limits, which begin where the influence of other social variables starts to be felt. Consequently, in order to improve the situation of the population of El Salvador a number of other measures designed to overcome poverty and inequality are also needed. It is not a question of reviving the violent social disputes of the past, but of bringing about the necessary changes within a climate of democratic coexistence.

Paradoxically, the polarization experienced by the country in the 1980s and the collapse of certain extreme social proposals have meant that in a poor country like El Salvador, with its enormous social disparities, certain social issues of a structural nature have had to be postponed because of the need to be-

gin a process of true democratization, to reconstruct the country, and to maintain a stable economy. In order for the present economic model to function properly, all members of society must have equal opportunities, otherwise the system would be very unjust and would keep alive many inequalities, even though many families might slowly begin to rise just a little above the poverty line. In the government's actions, education must be given a very important place, but within the context of a set of other measures in the social, economic, political, legal and cultural spheres which go to make up an integrated growth and development policy. It would not be a good thing for Salvadorian society to over-estimate or under-estimate the importance of education in development.

In view of the multidimensional nature of the task faced by that society, education should seek to transmit knowledge and skills from one generation to another not only in order to reproduce the legacy of the previous generation but also in order to raise the level of knowledge and the living conditions of the population: it should thus contribute to the change which, in the case of El Salvador and the other Latin American countries, means seeking fairer forms of social coexistence for all. This is education's role in furthering change: it should stimulate people to reflect on the situation, make adjustments, and create social, economic, political, scientific and cultural proposals. Although this manner of viewing education might seem a mere conceptual consideration, in reality it is much more than that. A form of education committed to the development of society and of the poorest sectors has practical implications for curricula and teaching practices at all levels.

When rethinking the purposes of education in El Salvador, they must include the promotion of political skills and habits of participation in a free, democratic context. Education, not hunger, must be the breeding-ground for social and political awareness. It is also important to bear in mind that education has an important role in terms of self-realization, so that it is valuable in itself, quite apart from any market-related considerations. It must always be remembered that education is a human right.

With regard to these considerations about the proper understanding of education and its real contribution to the country's development, it may be added that the Salvadorian educational system is far from

making its maximum possible contribution to society. In order for the system to be able to fulfill its objectives, various measures are needed, as detailed in the following paragraphs.

In the search for creative but soundly based solutions to the problems of education in El Salvador, it is important to raise the technical capacity of the Ministry of Education. It would be useful to give significant support to the professional development of its technical experts, university professors and researchers, and other professionals in non-governmental organizations active in the field of education. It would be highly advisable to revise the organizational structure, working procedures and systems of incentives of the Ministry and other institutions in order to stimulate professional development and research.

In this connection, a national debate should be promoted among the relevant professionals on the data generated by the system and the resulting ideas and proposals. To this end, the key information in the hands of the Ministry of Education –such as the results of the primary education performance tests and the Test of Learning and Aptitudes for Students Completing their Secondary Education– should be made public in a straightforward and transparent manner. It is true that there is a danger that the results might be used politically for or against the government, but it is also true that there can be no serious reflection in pursuit of solutions if these results are not revealed. Moreover, citizens and social institutions have every right to know how public systems are working. It is therefore necessary to provide more support for social research and evaluation of the educational system.

At the same time, efforts must be continued to expand coverage, especially towards rural areas and the poorest regions. Although much has already been done at the basic level, measures should now be taken to expand coverage at the pre-school and secondary levels. It is also essential to prepare a set of measures to ensure continuity in the post-secondary levels of education for the poorest students. At all levels, high-quality educational services must be developed for the poorer students. The traditional formal educational system is based on social assumptions which are different from those applicable to a large part of the population: it assumes, for example, that all students have the necessary backing to enable them to spend their time attending school.

As this ideal situation does not exist for a considerable sector of the population, however, and will probably not exist for several decades to come, even in the best of cases, educators should seek new ways of bringing education to the poorest sectors.

Furthermore, much of the working population ceases to have any links with the formal educational system. For example, 14% of the population of El Salvador are between 20 and 30 years of age and were educated under the educational system that existed before the reform process, and only 11% of this sector of the population is studying anything (El Salvador, Dirección General de Estadísticas y Censos, 1998). It is therefore essential to coordinate efforts to give those over 20 training opportunities that could raise their productivity.

With regard to improving the quality of education, one of the first measures should be to raise the professional level of teachers. Many training activities have been carried out since 1990, and they have made some contributions, but they have had some questionable aspects and have had little impact on teaching practices (FEPADE, 1998). It is urgently necessary to seek new decentralized forms of professional development for the 28,000 teachers which are economically sustainable and closer to the teaching model that it is desired teachers should follow in their classrooms. With time, technology and distance education could be incorporated in these efforts.

Teachers' training was recently restructured, and the changes have been well received by most sectors, although these changes must of course be continually evaluated in order to detect possible difficulties. At the same time, the faculties of education in the universities must be provided with more resources and with opportunities for the professional development of their professors, which would serve in turn to raise the level of the professionals trained in the universities and the quality of their work.

The poor results obtained in the national learning tests in language and mathematics indicate that specific measures of different types must be taken to gradually overcome these shortcomings. Pedagogical research and experimentation on these subjects are of decisive importance for designing suitable policies.⁶

⁶ In 1999, for the second year running, FEPADE opened a research fund for investigation into the learning of reading, writing and mathematics.

The phenomenon of repetition of grades in El Salvador must also be studied more closely in order to find out its main causes among the poorer sectors. The resources of the educational system and the students' learning opportunities would be greatly benefited by the application of policies specifically designed to solve this problem.

The educational system has begun a decentralization process, with some degree of success, transferring administrative authority to the regions and, in recent years, to the schools themselves. The present degree of delegation of authority, however, is not sufficient to enable each school to establish its own institutional profile or define, adapt or strengthen teaching processes (Carrasco, Guevara, Hernández and Rodríguez (forthcoming)). In other countries, the decentralization of school and teaching management to the school level has given rise to team work dynamics and the possibility of generating more pertinent and creative activities (Chile, MINEDUC, 1998). A wise measure that the Ministry of Education could apply would be to provide mechanisms, finance and technical assistance for school projects generated on a team basis which involve the community and present valuable and innovative proposals. Measures of this type can have important effects, since in addition to generating a different type of working culture in the educational centres they open up the possibility that the system can learn from the bottom up, from the schools themselves. School decentralization in El Salvador should promote greater autonomy in the educational centres in the medium term (Carrasco, 1998). Naturally, in order to be effective the decentralization process must be accompanied by timely technical support and financial resources to make the initiatives generated in the educational centres viable.

In any policy of decentralization towards the schools themselves, the position of the school director or headmaster is of key importance for promoting participative decision-making, cooperative work and autonomous management. It is therefore necessary to promote special arrangements for the professional development of school directors in such fields as leadership, participation, project preparation and evaluation, and school-community relations (Carrasco, 1998; Carrasco, Guevara, Hernández and Rodríguez (forthcoming)).

(Original: Spanish)

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In 1999 Latin America continued to be subjected to adverse influences from the international economic environment, which decisively conditioned the economic policies applied and the performance of the countries. The ongoing fall in the prices of non-fuel commodities and the instability and deterioration of external finance conditions resulted in a negative net transfer of resources for the region as a whole, for the first time since 1990, and made it impossible to maintain the previous upward trend in the deficit on current external transactions. The corresponding adjustment was accompanied by a slackening in domestic demand and imports, thus giving rise to virtual stagnation of the region's gross domestic product.

There was thus a further increase in unemployment. Inflation, however, continued to register a steady rate around 10% throughout the region, notwithstanding the more flexible exchange policies applied and the consequent currency devaluation in many countries. The countries in the south of the region were particularly hard hit by the crisis, and there was a sharp contraction in their mutual trade, which consists mainly of manufactures. In contrast, Mexico and the Central American and Caribbean countries were able to take advantage of the buoyant United States market to increase their exports and levels of economic activity, thus offsetting the harmful effects of the international financial crisis.

Towards the end of the year, the growth in the world economy, the tendency towards the normalization of capital flows and the improvement in raw materials prices combined with the attitudes of the macroeconomic authorities, now more favourable to reactivation, to give signs of a possible recovery in economic activity, which it is hoped will be significantly consolidated in the year 2000.

Economic Survey of Latin America and the Caribbean, 1998-1999, LC/G.2056, United Nations publication, Sales No. E.99.II.G.2, ECLAC, Santiago, Chile, September 1999, 326 pages plus statistical annex on CD-Rom (version 3.6).

This issue of the *Economic Survey of Latin America and the Caribbean, 1998-1999*, which is the 51st in the series, incorporates several changes compared with the previous issue, including a new graphical design and the fact that the statistical annex is now on a CD-Rom. A new methodology has also been adopted for analysing the situation of the individual countries (Second and Third Parts), in which figures taken from the national accounts of the countries are used, in national currency and with the base year used in those accounts, in-

stead of figures in dollars. In the statistical information in dollars used for the regional-level analysis (First Part), however, the same methodology as in previous years has been used and 1995 has been taken as the base year for the calculations at constant prices.

The changes made in 1995 as regards the reporting of prevailing economic conditions in the region have been maintained. The *Survey* is once again published in a single volume divided into three parts. In the First Part, the first chapter contains a general overview -also published separately as an offprint- which gives an appraisal of the regional economy covering 1998 and the first half of 1999. In the following six chapters, the economic performance of the region in 1998 is analysed, together with some aspects of its performance in the first half of 1999. Finally, the eighth chapter makes an appraisal of the impact of the global financial crisis on the economic development of the region.

The Second Part presents series on the performance of the 20 individual countries of Latin America in 1998, together with information on the first quarter of 1999. Part Three analyses the situation in the English-speaking Caribbean.

The statistical annex on CD-Rom provides rapid access to the data for recent years and makes it possible to create spreadsheet tables covering a longer period. It also includes electronic versions of the text and figures of the *Survey*.

Other publications

Transformaciones recientes en el sector agropecuario brasileño. Lo que muestran los censos (Recent changes in Brazilian agriculture. What the censuses show), LC/G.2064-P, United Nations publication, Sales No. S.99.II.G.48, ECLAC, Santiago, Chile, November 1999, 128 pages.

With the publication of the 1995/1996 Brazilian agricultural census (the previous census had been carried out in 1985), it is now possible to make a first analysis of the structural changes which have taken place in the sector over this period. The document reviewed here makes an in-depth study of the main changes in the structure of production and the use of production factors, especially labour and land.

The form of organization of Brazilian agriculture underwent significant changes in the 1990s. These were the result of a new macroeconomic situation which has led to changes in land use, such as a reduction in the area devoted to crops and natural pastures and an increase in the area of artificial pastures. A million farms have disappeared, together with 5.4 million jobs. These changes may be attributed to the economic adjustment policies applied and the dynamics of the sector, which have affected the use of agricultural and grazing land and the population living on it. They have also had an important impact on equity and the distribution of property.

Las dimensiones sociales de la integración regional en América Latina (The social dimensions of regional integration in Latin America), LC/G.2029-P, Rolando Franco and Armando Di Filippo (eds.). United Nations publication, Sales No. S.99.II.G.21, ECLAC, Santiago, Chile, August 1999, 223 pages.

This document has four parts. Part I includes two studies on the question of globalization and its social impact, as a broad frame of reference for the new forms of Latin American integration. The first study ("Social aspects of regional integration") looks at the processes of

globalization and regionalization of markets and their social repercussions in Latin America. The second study ("Globalization, integration and social cohesion: the case of MERCOSUR") also begins by considering the globalized international setting, going on to deal with social aspects of the MERCOSUR accord, as affected both by its economic and its political dimensions.

Part II, which contains four studies, deals with the social repercussions of market integration in terms of employment opportunities and labour relations. The first of these studies ("Labour markets, competitiveness and convergence") puts forward a general conceptual statement of the matter. The second ("Social dumping: social policy as trade policy") deals with the impact of wage differences on trade negotiations. The third study ("Labour institutions and labour relations in MERCOSUR") reviews the main organs, forums and commitments relating to labour aspects in the integration agreement. Finally, the fourth study ("Regional integration processes and social policies") analyses, among other questions, labour mobility, remuneration of the labour factor, and cross-border migrations.

Part III, which seeks to approach social aspects from a mainly political standpoint, contains two studies. The first of these ("Laying the political bases for economic integration: the Rio Group and regional concertation") highlights the importance of the return to democratically-based constitutional regimes in the 1980s. The second ("Updating the variables of Latin American integration") reiterates the need to restate the issue in all its multiple dimensions, which, in addition to the economic and political ones, also include those of social matters and mutual security.

The final part, Part IV, consists of two essays analysing the impact of cultural globalization on the forms of regional integration. The first of these essays ("New relations between culture, politics and development in Latin America") deals with four areas in which these aspects are closely inter-related. Finally, the second essay ("Globalization, trade agreements and indigenous self-development in Latin America") analyses the relations between the concepts and phenomena of economic integration, globalization in fields other than those of the economy, and indigenous self-development.



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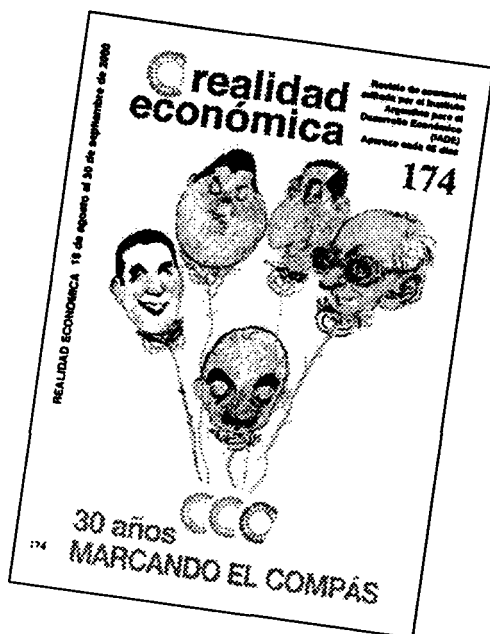
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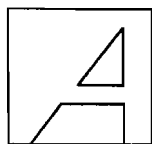
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