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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.
(—)	A dash indicates that the amount is nil or negligible.
	A blank space in a table means that the item in question is not applicable.
(-)	A minus sign indicates a deficit or decrease, unless otherwise specified.
(.)	A point is used to indicate decimals.
(/)	A slash indicates a crop year or fiscal year, e.g., 1970/1971.
(-)	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.

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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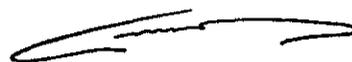


## Issue No. 50 of *CEPAL Review*

When the *Review* began publication in 1976, its purpose was twofold: it was to carry on the *Boletín Económico de América Latina*'s long tradition of exploring a variety of subjects relevant to Latin American and Caribbean economic development for a reading public who very probably cover a broader spectrum than does the readership of official ECLAC documents, and it was intended to give professional staff members of the Commission, who usually work anonymously as part of a team effort, the rare opportunity to publish their work under their own name.

Today, after nearly 17 years of continuous publication—first under the direction of Raúl Prebisch and then, from 1986 on, under the guidance of Aníbal Pinto—ECLAC is publishing the *Review*'s fiftieth issue. Thanks in large measure to these men, who have been so integral a part of the Commission's life as an institution, and to their respective collaborators, including the *Review*'s technical secretaries, from Adolfo Gurrieri on to Eugenio Lahera, this publication has ably performed those functions. The *Review* has indeed served as a forum open to all schools of thought, primarily for staff members of the ECLAC system but for others as well, and in so doing has managed to maintain its standards of technical excellence along with the relevance afforded by the analysis of topical events. Furthermore, both its Spanish-speaking and English-speaking audiences have been growing steadily.

We are therefore gratified to be marking this milestone in the life of a valuable publication which, we trust, will maintain and further enhance its present stature.



*Gert Rosenthal*  
*Executive Secretary*



## *In memory of Pedro Vuskovic*

*For those of us who shared many years of friendship and professional collaboration with Pedro Vuskovic, the news of his recent death in Mexico has been the cause of great sorrow, not only because of the circumstances of his death, following a cruel disease that gradually sapped his physical –but not intellectual– strength, but also because it signifies the loss of a great Latin American, of a teacher who helped shape so many generations of young people in our region, and of a companion during so many days of intellectual strivings and political struggle.*

*Pedro joined the Commission in 1950, shortly after its birth as an institution. For nearly 20 years he served it brilliantly in a professional capacity, with his career in ECLAC culminating in the position of Director of the Development Division. He played a crucial role in structuring and disseminating the thinking of ECLAC during a time when the very air teemed with the ideas and concerns of a pleiad of gifted economists and social scientists. These were the post-war years, the 1950s and 1960s, when we all had to "construct" Latin America. Pedro Vuskovic laid many of the bricks in that collective theoretical and political edifice which has been of such importance to the countries of the region. Concurrently, he served as a professor in ECLAC and ILPES training programmes while at the same time teaching classes at the schools of economics and sociology at the University of Chile and the School of Economics at the University of Concepción.*

*When he left ECLAC, Pedro plunged wholeheartedly into the academic world, serving as the Director of the Institute of Economics of the University of Chile, and then went on to claim a position at the forefront of Chilean politics. In November 1970 he was named Minister of Economic Affairs by President Salvador Allende and, in June 1972, took over the cabinet-level position of Executive Vice President of the Production Development Corporation (CORFO), where he served until September 1973.*

*When political events carried him into exile in Mexico, which generously welcomed him as it did so many other Latin Americans who faced similar problems, Pedro carried on his valuable academic work, first at the Economic Research and Teaching Centre (CIDE), where he directed the Institute of Economic Studies of Latin America, and later at the Centre for Interdisciplinary Research in the Humanities at the National University of Mexico (UNAM), where he was named to the position of Coordinator for a programme on poverty and development options in various countries of Latin America.*

*Although he will be remembered for his important political role, Pedro's work as a scholar and as an economist deserve special mention.*

*He was a brilliant speaker, at the same time both methodical and incisive, who mastered his subjects with great wisdom and intellectual breadth, and he derived a special joy from being with young people, from providing them with intellectual stimulation and receiving it from them in turn. The many generations of Latin American students who were fortunate enough to have him as a teacher can attest to this.*

*Pedro Vuskovic brought to his work as a researcher and teacher a deep sense of political and social responsibility which moved him to espouse the cause of Latin America's poor and dispossessed, whose position he had come to understand very early on in his life through the many studies he carried out in this area while at ECLAC. He was tenacious in upholding his ideas and principles, he lived in accordance with them, and he championed them in all the forums open to him, in both the political and academic worlds, to the end of his days.*

*His friends and colleagues also remember his geniality, his sense of humour and great personal warmth –traits which were coupled with an unshakable loyalty to his principles and values. Our farewell is deeply felt; Pedro Vuskovic has left us a legacy of memories and lessons that we will always hold close to our hearts.*

*On behalf of his friends and colleagues,*

*Jacobo Schatan  
former Director of the Joint ECLAC/FAO  
Agriculture Division*



# Regional integration *in the 1990s*

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**Gert Rosenthal**

*Executive Secretary of the  
Economic Commission  
for Latin America  
and the Caribbean  
(ECLAC).*

The renewed interest sparked by the potential for intraregional cooperation in Latin America and the Caribbean today has been reflected in numerous agreements regarding trade preferences and in attempts to establish free trade areas, customs unions or common markets. The possibility has even been discussed of setting up free trade arrangements on a hemispheric scale. This plethora of proposals inevitably raises a great many questions. What is the reason for this renewed interest? Are the differences between the schemes of today and those of the 1960s and 1970s significant enough to avert the obstacles and difficulties encountered by those earlier schemes? What are the most suitable mechanisms and instruments for promoting intra-Latin American integration? What are the defining characteristics of the various categories of integration initiatives, such as free trade areas, customs unions and common markets? Is it feasible to set up free trade areas involving countries having very dissimilar levels of development or macroeconomic policies? Would it be wise to work towards a gradual convergence of all these initiatives into a single, regionwide scheme? And most importantly: Just how functional would integration be in terms of the development strategies and policies adopted by the individual countries of the region? The various sections of this article attempt to answer, albeit tentatively, these questions.

# I

## Introduction

As a consequence of the protracted crisis of the 1980s and of changes in the international scene, in recent years Latin America and the Caribbean have exhibited a steadily increasing response capacity. Governments and civil societies have sought out new ways of adapting to changing circumstances and of responding to the numerous challenges they face. One of the many manifestations of this adaptation process is a renewed interest in the potentials of intraregional cooperation. In contrast to the atmosphere that surrounded the conclusion of formal economic integration agreements in the 1980s, lately the region has witnessed the proliferation of quite different sorts of arrangements, arrangements that display a high degree of heterogeneity in terms of both their modalities and their geographic configurations.

Indeed, numerous trade preference arrangements have been made, in most cases as part of the limited-

scope agreements provided for under the terms of the 1980 Treaty of Montevideo; attempts have been mounted to establish free trade areas (without necessarily adopting a common tariff); and efforts have been made to form customs unions (free trade areas combined with a common tariff) or common markets (customs unions involving some degree of macro-economic-policy coordination, especially with respect to foreign exchange matters, taxes and interest rates). For the first time ever, extending the coverage of free trade agreements to encompass the entire hemisphere has become a possibility; on a selective basis, the free trade agreement among Mexico, Canada and the United States which is now awaiting ratification and, on a more general level, the Enterprise for the Americas, announced in mid-1990 by the United States Government, both point in this direction.

# II

## Reawakened Interest in Integration

What accounts for this resurgence of interest in integration when, just a few years ago, the subject had virtually disappeared from the Governments' agenda of priorities? The continued development of the European Community and the formation of a free trade area between Canada and the United States have certainly helped to legitimize agreements aimed at establishing trade-preference groupings. In addition, the laborious, slow-moving progress of the multilateral negotiations being held within the framework of the General Agreement on Tariffs and Trade (GATT) has prompted many Governments to work towards the same objectives by means of partial-scope agreements with like-minded countries. In order to reconcile such initiatives with GATT, article 24 of the Treaty is usually cited, since this provision permits the establishment of trade groups among countries which grant each other reciprocal trade preferences without requiring that they necessarily be extended to the rest of the countries.

In Latin America and the Caribbean, a number of additional factors have helped to further enhance the legitimacy which the idea of integration as such has acquired at the international level. Some of these factors have arisen in response to the possibility of extending the free trade area existing between the United States and Canada to Mexico and, eventually, to other countries in the region. Others are discrete phenomena. Examples of the latter include the gradual convergence of the economic models being applied, the growing political affinity to be observed among democratically-elected civilian governments, a decrease in the potential costs of trade diversion thanks to an increasing degree of trade liberalization in almost all the countries of the region and, in general, a priori assessments of the situation which indicate that the potential benefits of such agreements will far outweigh their possible costs.

### III

## International positioning and integration commitments

It is also helpful to examine recent integration commitments within the broader context of the determined efforts being made by all the Governments of the region to improve their countries' positions within the international economy. This has been their response to the increasing globalization of the economy and to the shortcomings of the industrialization strategy followed by many countries in the past. In recent years, government action has been directed towards enhancing the international competitiveness of the goods and services that each country has to offer.

In the mid-1980s, intraregional trade agreements did not play a major role in the countries' efforts to improve their international positions; on the contrary, some experts maintain that they were leading in quite the opposite direction. This was because, first of all, the idea had taken firm hold that such agreements served the purposes of import-substituting industrialization but were of no help in an export drive; in some cases it even came to be believed that they actually hindered progress towards greater international competitiveness. Secondly, the Latin American and Caribbean regional market was smaller than that of the major economies of the Organization for Economic Cooperation and Development (OECD) and exhibited slow or zero growth. In the eyes of many Governments, the best course of action was therefore to concentrate on gaining access to large, fast-growing markets.

This view began to change for the reasons mentioned earlier and, above all, because enough information had become available to show that integration commitments among a given group of countries are not necessarily incompatible with the establishment of a more open and more transparent international economy. Thus, in recent years the idea has begun to gain acceptance, in both academic and government circles, that an open international economy free of artificial barriers to a free flow of trade in goods and services does not necessarily exclude the possibility of integration commitments and, in fact, that such

arrangements may even contribute to the achievement of that goal.

This is indeed plausible. From a conceptual viewpoint, integration commitments can contribute to the accomplishment of the main tasks on the regional development agenda. This statement is based on a number of well-known arguments, including the potential contribution of expanded markets to an increase in efficiency (as a result of economies of scale and the elimination or reduction of monopolistic rents) and to technical progress and innovation, as well as their effect on investment levels. Moreover, an implicit part of this reasoning is the assumption that the potential costs of trade diversion will tend to decrease markedly in the presence of widespread trade liberalization.

It is also true, however, that intraregional agreements and any future arrangements of a hemispheric scope need to be designed in such a way as to be conducive to the achievement of an international economy free of protectionism and of barriers to trade in goods and services. At the same time, we must be cognizant of the risk that the formation of economic blocs of developed countries may lead to a fragmented world in which trade flows freely within these groups but is subject to a greater degree of regulation between one bloc and another.

It is important to note that Latin American and Caribbean integration is justified –albeit for different reasons– in both cases, i.e., whether the formation of large groupings of developed countries helps facilitate the establishment of an integrated world economy or whether it contributes to the fragmentation of that economy. In the first case, integration would contribute to the achievement of the objective pursued by all the Governments of the region in the Uruguay Round; in the second case, at least it would place the region within one of the groups making up that fragmented international economy. From a regional standpoint, integration also offers a way of diversifying risk in an international economy that is rife with uncertainty.

## IV

### Main features of the new Integration commitments

If we are to describe existing integration schemes, we must first know what type of integration we are dealing with. The initiatives taken in the developed world have been exceedingly varied in nature. For example, the characteristics of the European Community's broad-ranging accords, which are leading it towards the formation of a regionwide economy, are a far cry from the types of commitments made by Canada, the United States and Mexico in the North American Free Trade Agreement. In East Asia, where no formal integration agreements have been concluded, trade liberalization and geographic proximity are none the less contributing to a steady increase in reciprocal trade, which is, moreover, being augmented by reciprocal investment. In this instance, geographic proximity and lower transaction costs are creating implicit preferences among the countries of that region and are thus facilitating the formation of another bloc of interdependent countries.

Along the same lines, the Latin American and Caribbean region of today abounds in agreements of widely differing characteristics and contents. At the risk of oversimplification, we may identify at least four types of trade-preference arrangements which can be defined in terms of the degree of commitment made among the countries concerned. The simplest category includes agreements for the reduction of tariffs on a given list of products, which are thus accorded preferential treatment *vis-à-vis* similar products coming from other countries. This type of bilateral or multilateral agreement does not involve any significant degree of economic policy coordination.

The second type of agreement calls for a more comprehensive form of tariff reduction, and in this case the corresponding negotiations therefore focus on the lists of exceptions rather than on the products to be subject to liberalization measures. The result is the creation of a free trade area that does not

set up a common level of protection in respect of non-member countries. In such cases it is possible that products from the rest of the world may be brought into the country with the higher tariffs via an indirect route by taking advantage of the lower tariffs of the other member countries of the free trade area; to this end, the products in question are first exported to the lower-tariff member countries and are then re-exported to another country under the provisions of the free trade agreement. The conventional method of blocking this indirect flow of imports from the rest of the world is to establish rules of origin for products included in the free trade regime; under such rules, a given level of processing or a specified percentage of national content is required.

The third category of agreements are those that not only set up a free trade area but also add to it a common tariff in order to forestall the relative price distortions that can be caused by tariff-generated cost differences. The advisability of setting up a common external tariff for the members of an integration scheme—which is the main difference between a customs union and a free trade area—will depend on the characteristics of the countries involved. Assuming that their levels are low, common tariffs would be more justified for countries having a large volume of reciprocal trade and similar economic structures. Under these circumstances, the application of differentiated tariffs to the various products would create unequal levels of effective protection for each party and would set the stage for charges of unfair trade practices and the establishment of trade restrictions, as well as encouraging contraband trade.

In the fourth category of agreements, a free trade area and common tariff are coupled with a programme of macroeconomic policy coordination. The aim of such a programme is to avert distortions in relative prices caused by cost differences attributable to the exchange rate, export subsidies, rates of taxation or interest rates.

## V

### Some requirements

The foregoing suggests that the level of commitment which any given group of countries will be prepared to make will depend on how economically interdependent they are, how similar their approaches to macroeconomic and policy management are, how complementary their economic structures and stages of development are, how much they trust each other, and many other factors. The economic ramifications of each type of arrangement in terms of potential costs and benefits will vary from one situation to another.

This underscores the complexity of the many arrangements currently existing in the region and raises the question as to whether it would be wise to seek an eventual convergence of all these schemes or whether it would be better to permit the emergence of a range of different types of agreements reflecting the different types of situations which do, in fact, exist in the region. The second option would appear to be more realistic, at least for the foreseeable future, al-

though it would be advisable to promote the adoption of some common standards regarding the application of mechanisms and instruments in order to pave the way for any subsequent bid to expand the geographic scope of existing agreements.

What is true for Latin America as a whole is not necessarily valid for subregional processes which have already generated a high degree of economic interdependence, however. The fact, for example, that some countries in Central America seem to want to move forward more rapidly than others could at some point jeopardize the consolidation of their subregional integration process. There is, then, a limit to the feasibility of allowing many different agreements to coexist within a single subregional process. This limit is reached when commitments which some countries wish to make will adversely affect the commitments already made by all the countries participating in a given subregional integration process.

## VI

### Trade mechanisms and instruments

With respect to mechanisms and instruments, if the economic subregions being formed are to be in keeping with the principle of multilateralism, some requirements regarding the content of bilateral and subregional agreements will have to be met; in essence, this means that the regulations and standards established by such agreements need to be in accordance with the provisions of GATT, to which the vast majority of the countries in the region have adhered.

Integration arrangements' common denominator is that they seek to reduce tariffs with a view to the formation of a free trade area. The agreements signed in recent years tend to cover a wide range of products, and negotiations have therefore centred around the lists of exceptions rather than the lists of products

to be subject to liberalization measures. Furthermore, the areas of activity or products placed on those lists of exceptions are usually limited to those regarded as "sensitive", such as the automobile industry in Mexico or grain crops in many countries.

Tariff preferences are usually granted on the basis of a tariff reduction timetable which, starting from the maximum tariff rates in effect, gradually leads to full trade liberalization (a zero tariff rate) among the parties concerned. These agreements should also include precisely defined rules of origin to facilitate customs operations and prevent indirect importation, as well as setting up transparent, non-discriminatory, permanent safeguards and clear, flexible procedures for settling trade disputes. Such agreements are usually accompanied by commitments

regarding the gradual elimination of non-tariff trade barriers and other subjects on the GATT agenda, such as trade in services and standardized regulations in the area of intellectual property.

If such agreements are limited to the creation of a free trade area, and if they also give rise to large-volume reciprocal trade flows, there will be a tendency to broaden their scope in order to prevent price differences attributable to disparate conditions in the various signatory countries—tariffs, export subsidies, tax rates, interest rates—from heightening relative price distortions and influencing decisions regarding the location of new production activities designed to supply this expanded market.

This is why the parties to an agreement aimed at promoting trade, investment and cooperation may feel it is necessary to establish a common tariff and align some of their macroeconomic policies (MERCOSUR, the Central American Common Market, the Caribbean Community, the Andean Group). However, although such measures will help to align conditions in the member countries, they will also result in a greater subordination of domestic policy to these integration commitments.

## VII

### Other integration mechanisms

As stated earlier, today there is a widespread tendency to regard the pooling of markets as the pivotal element in integration agreements. This frequently prompts charges that excessive importance is being attributed to trade arrangements at the expense of other potential benefits of integration. The first factor to be borne in mind in this regard is that the primary purpose of these arrangements is not to increase trade as much as it is to stimulate production and boost productivity.

Secondly, trade arrangements do not preclude the promotion of other more specific cooperation initiatives; in fact, they may help bolster such efforts. For example, joint projects aimed at improving infrastructure and transport services, electrical power generation and distribution systems, technological

By the same token, some of these accords provide for plans to phase out export subsidies and discriminatory taxes, the elimination of transport-related barriers to foreign trade, and the adoption of agreements regarding services and investment. In the case of the North American Free Trade Agreement concluded by Mexico, Canada and the United States, a marked emphasis on agreements concerning intellectual property, environmental protection and workers' rights is also to be observed.

This does not mean, however, that as the commitments made by the countries are fulfilled, this process will inevitably give rise to new and deeper commitments. Indeed, the experiences of the 1960s suggest that it may be unfounded to take a linear view of integration commitments as leading to greater and greater levels of interdependence.

It should also be noted that agreements regarding tariff levels are sometimes supplemented by other measures—e.g., in the area of government purchasing—which tend to give preference to the acquisition of goods and services from other signatory countries.

research and human resources development, especially in highly specialized fields, can obviously benefit all parties concerned.

Moreover, the implementation of integration agreements will be furthered by the adoption of specific, ongoing programmes to promote trade and investment. In recent years meetings of entrepreneurs and employers, dissemination activities and development agencies have all helped to promote co-investment and to step up trade among various countries of the region. An effort should also be made to encourage intra-Latin American investment, which could become an important vehicle for technological innovation regardless of the types of formal agreements concluded by groups of countries.

## VIII

### Hemisphere-wide agreements

No analysis of contemporary integration agreements can fail to mention a subject that would have been completely unthinkable just 10 years ago: the incorporation of Latin American countries into a free trade area with highly developed countries or, in other words, into an arrangement of reciprocal concessions. What makes it possible even to entertain this possibility, from the standpoint of the Latin American countries, is that unilateral processes of trade liberalization have reached such a point that national producers are now faced with competition from the most efficient of international producers regardless of whether formal integration agreements are in place or not.

In other words, by way of example, it was probably more traumatic for Mexican industry to make the transition from the unbounded tariff protection it enjoyed in the mid-1980s (such as was afforded by import permit requirements) to its present moderate levels of protection (tariff rates of about 10%, on average) than it will be for it to move from the present situation to the zero tariff rate that is to apply to imports from the United States and Canada. In return, Mexican producers will have more secure access to those countries' markets and will have the opportunity to join in new production activities that will be set up to supply this larger shared market.

Of course there will also be risks. Many activities –on both sides of the border– will succumb to

the increased competition, and the Governments may find that they have less manoeuvring room in their management of macroeconomic policy. But in an imperfect world, and in view of the protectionist winds that are blowing in many parts of the world, the possibility of joining in a free trade area with the United States and Canada would seem to be an attractive option for many Latin American countries, especially in an international setting that does not afford an abundance of opportunities. This is all the more so in view of the fact that the act of signing integration agreements with the United States and Canada will not necessarily prevent the region from expanding its commercial and financial ties with other centres of growth in the international economy.

As we said at the outset, the United States' sudden interest in signing agreements to set up a free trade area with its neighbours has had a profound impact on intra-Latin American integration schemes. Moreover, the instruments provided for under the North American Free Trade Agreement (NAFTA) are essentially the same as those being applied under the terms of subregional integration agreements in Latin America. Hence the need to continue to explore regional integration and hemispheric integration as two facets of the same subject.

## IX

### The problem of the less developed countries

The greatest obstacle to integration during the 1960s and 1970s was probably the poorest countries' opposition to the planned distribution of the presumed costs and benefits of integration. Today, however, to our astonishment, we see that these same countries are willing to undertake commitments for integration with such highly industrialized countries as the United States and Canada.

This is one of the many consequences of the wave of trade liberalization that has washed over the world. In fact, even the doctrine of non-reciprocal preferences for the poorest countries has begun to give way to the principle of reciprocity in such agreements. In this respect, the nature of the problem posed by the less developed or smaller countries has changed radically in recent years.

None the less, we should not allow ourselves to be carried away by this new trend, since common sense still tells us that, due to diseconomies of scale and shortcomings in the areas of organizational capacity and financial soundness, many firms in the region are not in a position to compete with their United States counterparts. At the very least, one would hope that longer transition periods would be provided for firms in the less developed countries to gear up to face this new type of competition, and

perhaps more flexible rules regarding value added (origin). In addition, integration initiatives should not only promote trade liberalization but should also serve to create conditions conducive to a broad-ranging dissemination of technologies by means of such measures as the enactment of flexible legislation in the area of intellectual property, the establishment of information networks, the mobilization of skilled human resources and the promotion of foreign investment.

## X

### Conclusions

A great many conclusions can be drawn from the above discussion. Perhaps the main one is that, just as economic integration played a functional role in the import-substitution model of decades past, it can also do so in the contemporary model for enhanced competitiveness in the international market. It may even be that the potential benefits of integration are greater than those suggested by a static analysis of trade creation and diversion, since the impact of these broader arenas for economic activity in terms of innovation and improved resource allocation—at the company level and within the overall system to which those firms belong—will surely contribute to an increase in productivity and efficiency.

Secondly, recent intra-Latin American (and, some day, intra-hemispheric) integration pacts are compatible with the stated objective of virtually all the countries of the region of improving their position within the international economy. For the most part, these agreements abide by the spirit and letter of GATT while seeking to raise the level of competitiveness and promote market diversification in order to reduce the risk represented by total reliance on the demand of OECD countries. Indeed, these agreements can be viewed as a sign of the fact that the countries are exercising their right to choose options which will enable them to develop their potentials in an uncertain and fiercely competitive international economy. None of the agreements signed to date is being pursued “at the expense of” another grouping but rather as a means of making progress, in the company of a group of similar countries, towards the achievement of the major objectives of the

multilateral negotiations being conducted within the framework of GATT (the Uruguay Round).

A third conclusion concerns the present way in which the countries are approaching their integration commitments. What is different is not the agreements’ means of implementation, but rather the context in which they are being applied. In other words, as the globalization of the economy proceeds, tariff preferences as well as rules of origin and safeguards are taking on a very different meaning from what they signified in a situation marked by high levels of tariff protection. On the one hand, the costs of trade diversion are now much lower than they used to be; on the other, the substantial reduction in tariff levels already carried out in the region makes tariff preferences less important than before, while bilateral agreements regarding other trade policy tools—safeguards, anti-dumping measures and rules of origin, as well as sectoral arrangements—may hinder trade rather than promoting it.

Fourthly, existing integration agreements in the region are notable for their diversity, inasmuch as they range from relatively simple agreements involving few formal requirements (superficial integration) all the way to initiatives calling for the formation of an advanced form of economic union (comprehensive integration). This makes it difficult to envision the configuration of a regionwide free trade area in the foreseeable future; instead, it would seem wise to encourage the conclusion of a number of different agreements whose contents would vary according to the relevant parties’ degree of similarity and as the circumstances of each country grouping would appear to dictate.

This having been said, a fifth conclusion is that there is a limit to how many agreements there can be, since, under certain circumstances, different agreements could conflict with one another. What is happening at the present time in Central America is an example: no country in that subregion can enter into negotiations on its own regarding tariff concessions with an outside country because this would infringe upon the common Central American tariff. In these cases, the procedure is for the member countries of a given group that have a greater commitment to integration to negotiate agreements with third-party countries on a joint basis. The interests of eventual convergence would also be served, at least in some cases, if integration groups agreed to abide by common rules and procedures.

A sixth observation is that, in situations where the countries engage in a considerable volume of reciprocal trade, have similar production structures and are geographic neighbours, there will be a strong tendency to complement a free trade area or a system of trade preferences with a common tariff in order to ward off distortions in resource allocation and to avoid encouraging contraband trade. In such situations, it is also important to align the countries' macroeconomic policies, since marked differences in

exchange rates or regulations, interest rates or taxation levels can produce as much distortion as differences in tariff levels can. This undoubtedly introduces a greater degree of complexity into the administration of integration agreements.

A seventh conclusion is that trade preferences can and should be complemented by other joint measures to resolve shared problems in a wide range of areas, including the development of infrastructure, technological research, marketing, finance and training.

Finally, we can see that Latin America is currently going through a period of innovation in respect of integration-oriented institutional arrangements. It would seem that the Governments prefer to work with existing mechanisms rather than establishing common institutions. Accordingly, some processes are being guided by intergovernmental commissions while others receive support from ad hoc secretariats. There is apparently some resistance to delegating authority to intergovernmental or supra-national agencies. Private enterprise has also gained in importance as a leading actor in the integration process, both through investment in neighbouring (or more distant) countries and in its role as a vector of technology.



# The integrationist revival: *A return to Prebisch's* policy prescriptions?

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This paper revisits Raúl Prebisch's views on an issue that has become central to trade and development policy in the 1990s: the relationship between industrialization, regional economic integration and outward-oriented growth. The author argues that, whereas these elements have been interpreted as relatively separate components of Raul Prebisch's thinking, they are in fact organically related in the dynamic sequence of development policies formulated by Prebisch. Far from remaining locked into an inefficient import substitution industrialization path (hereinafter referred to as "ISI"), for Prebisch the gradual and negotiated incorporation into increasingly wider commercial relationships was the key to economic progress. Regional economic integration and periodical revisions of external tariffs to keep protection within moderate levels were essential ingredients for reaching a stage of reciprocal trade in industrial products with the centres, which Prebisch considered as the only option for breaking the centre-periphery asymmetries, increasing income and employment, and raising living standards in developing countries. Thus, the author concludes, rather than departing from Prebisch's long-term vision, the search for a new high-quality international insertion and the integrationist revival in Latin America might be interpreted as a reassertion of the sequence of policies originally envisaged and recommended by him. Going on to examine the usefulness of some of Prebisch's ideas for present discussions of international insertion and regional integration, the author argues that Raúl Prebisch's ideas on economic integration, outward-looking growth based on industrial export promotion, selectivity based on world income-elasticity criteria, and reciprocity, appropriately adapted to present conditions, are relevant for the rethinking of the strategy of international insertion complemented by regional integration which the Latin American countries are presently busily embarked upon.

# I

## Introduction

This paper revisits Raúl Prebisch's views on an issue that has become central to trade and development policy in the 1990s: the relationship between industrialization, regional economic integration and outward-oriented growth. Whereas these elements have been interpreted as relatively separate components of Prebisch's thinking, they are in fact organically related in the dynamic sequence of development policies formulated by him.

The main argument can be summarized as follows: Prebisch's analysis led him to conclude that industrialization was necessary for peripheral countries in order to absorb population growth, while raising productivity and living standards. However, it is often overlooked that the key issue for Prebisch was not to remain locked-in in an import substitution industrialization (ISI) path, but to use ISI as a transition policy that, aside from its own dynamic benefits (investment, employment, learning), would allow Latin American countries to reach a stage of reciprocal trade in industrial products with the centres. According to Prebisch's analysis, it was precisely the achievement of this reciprocal trade in industrial products with the centres that would break the negative results for the periphery of the centre-periphery model. Furthermore, in the dynamic scenario and succession of stages that Prebisch proposed as a long-term strategy, economic integration was an essential ingredient for efficient import substitution and subsequent industrial export expansion.

In practice, however, the development of ISI policies in Latin America departed radically from Prebisch's prescriptions in at least two fundamental respects: the persistence of extremely high levels of protection, and the very limited success in regional economic integration. Prebisch considered the simultaneous application of both policies—external tariff reduction and regional economic integration—critical to promoting industrial exports to the centres, and he repeatedly denounced the failure to implement his policy recommendations as a costly and misguided approach.

Unfortunately, numerous critiques of the "ECLA model" have failed to stress the fact that Prebisch's and ECLA's prescriptions were not followed in practice. A careful reading of Prebisch makes it very clear that, ironically—and for economists unfamiliar with Prebisch's thought also surprisingly—the present opening of trade regimes and the integrationist revival in Latin America might be interpreted as a return to the development path and the sequence of policies originally formulated by him. If there was a "lost decade" in Latin America it was largely due to the failure to follow the "rational" mix of policies for efficient industrialization recommended by Prebisch.

The above argument, developed in sections II to IV below, does historical justice to Raúl Prebisch's thought and demonstrates that he was no simple protectionist. A separate issue, discussed in section V, is the usefulness of Prebisch's ideas for present-day discussions of international insertion, export promotion and regional integration.

# II

## The need to industrialize

Prebisch's basic analytical instrument was the centre-periphery model. The economic dynamics of this model is given by the interaction between technical

progress, market structure and income flows. On the basis of this analysis, Prebisch concluded that the deliberate promotion of industrialization, together with the development of complementary activities (transport, trade, services), was a necessary policy for peripheral countries in order to absorb population growth while raising productivity, income and living standards.

■ The author wishes to express his thanks to Eduardo Lizano and Sylvia Saborío for their valuable comments on an earlier draft.

Prebisch justified the priority assigned to industrialization as a development strategy as follows: on the one hand, technical progress in primary activities makes the displacement of labour out of agriculture and traditional primary exports inevitable. Hence, these sectors cannot productively absorb the population growth nor labour made redundant by technical progress. The competitive structure of world primary commodity markets, the homogeneity of these products, and the condition of abundant labour supply in primary commodity production in the periphery, make it difficult, if not impossible, for exporting countries to appropriate the income gains of improvements in productivity. Instead, these benefits are transferred to consumer countries via lower prices.

On the other hand, market structures in the manufacturing sectors of the centres imply that economic agents (entrepreneurs and labour) have the capacity to appropriate the benefits of productivity gains. In addition, income elasticity of demand for primary commodities in the centres is low, while income demand elasticity for industrial products in the periphery is high. These asymmetries exert differential pressure on the relative prices of primary commodities and manufactures, leading to a secular deterioration in the terms of trade of the periphery.<sup>1</sup>

Prebisch concluded, therefore, that as long as the periphery specialised in primary commodities and the centre specialised in manufactures, it would not be possible for the periphery to narrow down the income differences with the industrial centres, even if there were improvements in productivity. Peripheral countries would continue with lower average income unless they could change this pattern of international specialization by promoting exports of industrial products to the centres.

Breaking the fundamental asymmetries of the centre-periphery model therefore required a change in the pattern of specialization of the periphery towards the development of competitive exports of manufactures to the industrialized centres. Within this economic dynamics, ISI was not a long-term strategy, but was rather seen by Prebisch as a transitional strategy to achieve this new pattern of international specialization.

However, according to Prebisch, for ISI to be the basis for the promotion of industrial exports to the centres the simultaneous application of two policies was critical: progressive forms of regional integration; and appropriate incentive policies, especially periodical reforms of the protectionist tariff *vis-à-vis* the rest of the world. Let us now look at these elements in turn.

### III

## Economic integration as an Imperative for efficient ISI and a new outward-oriented strategy

According to Prebisch: "The urgency of the need for progressive forms of economic integration began to claim attention from the time of the secretariat's very earliest studies, subsequently reasserting itself..." (Prebisch, 1959a, vol. I, p. 466).<sup>2</sup> In one of his

earliest contributions –his introduction to the *Economic Survey of Latin America 1948*, Prebisch warned that:

"It is necessary to define with precision the objective that is pursued with the industrialization policy. If it is considered as a means to achieve the ideal of autarky, in which economic considerations do not matter, any industry that substitutes imports would be admissible. But if the purpose is to increase what has been justly called the measurable welfare of the masses, we have to be clear about the limits beyond which more industrialization might imply a reduction of productivity" (Prebisch, 1949, vol. I, p. 105).

<sup>1</sup> For a formalization and discussion of the fundamental aspects of the centre-periphery model, see Spraos (1983).

<sup>2</sup> The page numbers for all quotations of Prebisch included here (except those for 1984) correspond to the two-volume edition of the *Selected Works of Raúl Prebisch*, edited by Adolfo Gurrieri and published by Fondo de Cultura Económica (1982). In all quotations, the italics correspond to Prebisch's own emphasis.

In this early work he includes a section entitled: "The limits of industrialization", and argues that:

"One of the limits is given by considerations regarding the optimal size of industrial enterprises. Latin American countries are, in general, trying to develop on one side of the border the same industries as on the other side. *This tends to diminish productive efficiency and conspires against the social objective that is being pursued. This is a very serious short-coming...* This parceling out of markets, with its intrinsic inefficiency, constitutes one of the main limits to the growth of industry. However, far from being insurmountable, a clear-sighted policy of economic interdependence could remove it and generate large mutual benefits".<sup>3</sup>

In the 1954 Quitandinha report (Prebisch, 1954),<sup>4</sup> he devotes a complete section to the "Liberalization of inter-Latin American Trade" and warns that: "*Industrialization is developing in separate compartments and trade in manufactures between Latin American countries is very small*" (Prebisch, 1954, vol. I, p. 378). "*In a liberalized trade regime productive specialization, and its well-known advantages becomes possible, but in a regime of separate compartments high-cost production is frequently incurred due to the insufficiency of the national market*" (op. cit., p. 379). Therefore, as import substitution advances "*...towards products that can only be economically produced on a large scale, and this exceeds the size of the national market, the need to develop reciprocal trade among Latin American countries asserts itself*" (op. cit., p. 378).

Prebisch's ideas on economic integration are developed fully in his 1959 book *The Latin American Common Market*. Here he clearly formulates a dynamic scenario involving import substitution in the context of an expanding common market as an essential element for both sustaining a satisfactory rate of overall growth and promoting efficient industrialization, leading to a stage of mutually beneficial trade in industrial products with the centres. The starting point for his analysis is the thesis that: "The fundamental economic problem of Latin America is how to achieve a satisfactory rate of economic growth that would allow it to progressively reduce the income differences with the large industrial centres" (Prebisch, 1959a, vol. I, p. 469).

<sup>3</sup> Prebisch also insists on these points in the *Economic Survey of Latin America 1949* (United Nations, 1951).

<sup>4</sup> Report presented by Raúl Prebisch to the Fourth Extraordinary Meeting of the Economic and Social Council of the Organization of American States, held in Quitandinha, Brazil, 1954.

Based on the need to solve this "fundamental economic problem", he gives four related rationales for the importance of economic integration: i) a growth argument, ii) an efficiency argument, iii) an industrial export expansion to the rest of the world argument, which in modern language we could call an international competitiveness argument for regional integration, and iv) a reduction of external vulnerability argument.

### 1. The growth argument

According to this argument, the main obstacle to growth in Latin America is the balance of payments constraint imposed by the slow rate of growth of exports of goods and services relative to the high rate of growth of imports: a trend resulting from the basic centre-periphery specialization and its intrinsic asymmetries. To sustain a rate of growth of GDP higher than the relatively slow growth of exports, without running into this balance of payments constraint, the import coefficient (total imports/GDP) has to be reduced, and this can only be achieved through an intensive process of import substitution.

In this scenario: "The gradual implementation of a common market would make it possible to compensate, at least partially, the reduction in the import coefficient with the rest of the world required by the slow growth of primary commodity exports, through an increase in the coefficient of reciprocal imports" (Prebisch, 1959a, vol. I, p. 472). Prebisch provides empirical support for his argument by pointing out that while Latin America has an average global import coefficient of 7.7%, of which intraregional trade is only 1.7%, Europe has a global import coefficient of 18.5%, of which 50% is intraregional trade and the other 50% is trade with the rest of the world. The United States has a lower import coefficient with the rest of the world than Europe and even higher relative levels of intraregional—that is, interstate—trade. Thus, Prebisch concludes, the main source of growth within the common market would be precisely the reciprocal expansion of industrial exports among the members.<sup>5</sup> By deliberately promoting

<sup>5</sup> Research on trade flows in economic integration schemes has given a solid empirical foundation to this expectation, albeit in an unexpected way. This research found that the increase in trade among the members of integration schemes has taken place largely through specialisation in production and export of products of the same industries (intra-industry trade), rather than of different industries (Tharakan and Kol (eds.), 1989; Willmore, 1974).

economic integration, Latin American countries could significantly increase their rate of growth and industrialization:

"If a country sets itself to grow at a higher rate than the slow rate imposed by the growth of its exports, at present it does not have any other alternative than substituting with internal production most of what it imports. The common market will open another option: to develop industrial exports to the other member countries with the purpose of supplying itself with products that otherwise it would have had to substitute. In this way, *instead of trying to establish all sorts of import substitution industries, each country could specialize in those more appropriate according to its natural resources, the skills of its population and the possibilities of its own market*, and will use imports from the other members to satisfy other needs for industrial goods that could not have been satisfied by importing from the rest of the world" (Prebisch, 1959a, vol. I, p. 476).<sup>6</sup>

## 2. The efficiency argument

For Prebisch, an efficient process of industrialization would depend on the continuing and systematic expansion of markets. As shown above, ever since his early contributions to the *Economic Survey of Latin America* of 1948 and 1949, Prebisch emphasized the limits that a narrow market imposes for efficient ISI.

By 1959 Prebisch was strongly denouncing the actual course being taken by ISI and the resulting inefficiencies. He directly linked these to two factors: i) the lack of success in economic integration efforts, and ii) the exaggeration and abuse of protection.

As regards the former, "the chief weakness of the industrialization process consists in the fact that it has developed in watertight compartments, within which each country attempts to do the same as the rest, without specialization or reciprocal trade" (Prebisch, 1959a, vol. I, p. 495). And, "...if a common market is not organized, each country, forced by the inevitable need to substitute imports, would have to do it *at extremely high costs*. This is a very important point, *because industrialization is not an end in itself but an efficient means to increase average productivity and, with this, the living standard of the population*" (Prebisch, 1959a, vol. I, pp. 471-472).

Clearly, for Prebisch, economic integration was not just important but absolutely essential for an efficient ISI process.

## 3. The industrial export expansion to the rest of the world argument

Prebisch notes that: "It might seem somewhat paradoxical that these countries (in Latin America), that still require tariff protection, could compete in manufacturing in the territory of the large industrial centres. But this is precisely what the European countries are doing in the U.S. market. Furthermore, there are some Asian countries that are successfully developing textile and apparel exports to Europe" (Prebisch, 1959a, vol. I, p. 473).

The possibilities of expanding industrial exports to the rest of the world are determined by two factors, according to Prebisch: Latin American competitiveness, and the willingness of the industrial centres to grant market access to Latin America. Interestingly, the development of competitiveness, in turn, would critically depend on: i) the effective development of regional economic integration, and ii) the periodical revision of the external protective tariff. Thus, "[...] *the common market, by helping to lower costs, might boost certain lines of industrial exports*" (Prebisch, 1959a, vol. I, pp. 473-475).<sup>7</sup>

In 1961 Prebisch summarized what he considered as the three basic failures of industrialization. As failure number one he stressed the fact that "*all industrial activities are oriented towards the internal market. [...] Development policy has discriminated against exports. [...] It has subsidized – by means of tariffs and other restrictions– industrial production for internal consumption, but not that which could be exported*" [...] "*The common market constitutes a partial solution to this problem. [...] The development of industrial exports between Latin American countries will lead to lower costs of production and will give certain industries possibilities of exporting to the rest of the world. A policy of stimulus (to industrial imports from Latin America) and cooperation by the industrialized countries might intensify this movement*" (Prebisch, 1961, vol. II, pp. 85, 88 and 89).

<sup>6</sup> This argument is also the basis of his concept of *reciprocity* in inter-Latin American trade, analysed in section V below.

<sup>7</sup> This scenario was formalized by Paul Krugman in Krugman (1984).

As regards the exaggeration and abuse of protection, in 1959 Prebisch observed that cost reductions for efficient import substitution had not occurred to a sufficient degree because *“since in many cases protectionist policy, in the shape of very severe import restrictions –if not bans– has been carried too far, the atmosphere of competition in the internal market has become appreciably less intense”* Therefore,

*“The return to the customs tariff as an instrument of protection, the lowering of intraregional duties in some cases and their abolition in others, would do much to restore the spirit of competition, greatly to the benefit of industrialization policy.* In this new environment, the gradual development of a flow of industrial exports to the rest of the world might be one of the objectives of Latin American trade policy. [...] It is thus possible to imagine reciprocally advantageous patterns of industrial trade which would have a significance very different from that of the traditional exchange of raw materials for manufactured products.” In order to achieve that, however: “trade policy would have to be readjusted in keeping with the new state of affairs. Otherwise, the Latin American common market would not suffice in itself to foster trade with the great industrial centres” (Prebisch, 1959a, vol. I, pp. 474-475).

The fundamental importance Prebisch attributed to the promotion of industrial exports to the industrial centres is clear from the following:

*“The gradual formation of a Latin American common market...opens up possibilities for the industrialized countries and for Latin American countries to take fundamental decisions for the world trading system... These decisions will determine whether development will continue to be inward-looking within the Latin American common market, with as much foreign trade as the growth of exports to the rest of the world would permit; or whether it would be outward-looking, not by reproducing the old forms of international division of labour, but by developing new forms that might powerfully contribute both to Latin American industrialization and to the movement in the industrial centres towards higher stages of technology and productivity”* (Prebisch, 1961, vol. II, p. 95).

In his 1964 report to the Second United Nations Conference on Trade and Development, as Secretary-General of UNCTAD, he not only reiterates the above arguments but also includes a chapter entitled

“Industrialization and the need to export manufactures”, where he again emphasizes in even stronger terms “the unavoidable need to develop industrial exports” (Prebisch, 1964, vol. II, p. 247).<sup>8</sup>

#### 4. The economic integration and external vulnerability argument.

The external vulnerability of the ISI process was attributed by Prebisch to the failure to promote economic integration:

*“One of the paradoxes of economic growth in Latin America is that countries that tried to reduce their vulnerability through industrialization have found themselves in a new type of vulnerable situation.* This is due precisely to the fact that the substitution policy has occurred in watertight compartments. In the most advanced countries of Latin America, ISI has reached such extremes that imports have been reduced to those products that are essential for maintaining economic activity. Thus, when export earnings fluctuations reduce the capacity to import, given that the proportion of current consumption goods to which import restrictions can be applied is very small, it is necessary to apply these restrictions to essential products. [...] *While before, the economy was vulnerable on the demand side, now it is vulnerable on the supply side: the reduction of essential imports affects the level of employment”* (Prebisch, 1959a, vol. I, p. 478).

This shortcoming can be overcome, according to Prebisch, by promoting economic integration: “The establishment of a common market would make it possible to gradually correct this trade distortion and would help prevent it in the countries in which it has not already occurred” (Prebisch, 1959a, vol. I, p. 479). “In reality, the common market is a response to the objective of creating a new pattern for Latin American trade capable of meeting two exacting demands, namely, industrialization and the need to lessen the external vulnerability of the Latin American countries” (Prebisch, 1959a, vol. I, p. 468).

<sup>8</sup>In his 1984 retrospective article Prebisch characterized the late 1950s and early 1960s as the “third stage” of his thinking, whose distinctive features were strong criticism of the course taken by ISI policies, and emphasis on the urgent need to promote economic integration and industrial exports to the centres (Prebisch, 1984).

In conclusion, clearly Prebisch's long-term vision included a dynamic sequence starting from an inward-looking ISI process, efficiently developed through progressive integration into a common market and periodic revisions of the protective tariffs,

with the purpose of gradually changing the traditional pattern of specialization of the centre-periphery model into a pattern of mutually beneficial reciprocal trade in industrial products with the centres.

## IV

### The transition to outward orientation

Despite the importance given by Prebisch to the promotion of industrial exports to developed countries, an explicit analysis of the characteristics of the period of transition towards the new outward-looking stage is not found in Prebisch's writings until the early 1960s. However, even then the analysis does not enter into specific mechanisms nor policy instruments.

#### 1. Import liberalization and resource reallocation

In 1961 Prebisch refers not only to the reduction but to the "eventual elimination" of protection in the following terms:

"As industrial export activities (to the centres) demonstrate their capacity to absorb at high productivity a growing proportion of the labour force, the differences in protection levels (with the centres) could be progressively narrowed down. *Of course, in reducing and eventually eliminating protection in a growing number of industries, some might be injured, but this would be compensated by the reallocation of factors to more efficient export industries.* However, it is not conceivable that in Latin American countries this policy of import liberalization could be an objective to be achieved in the short term. A very long period of time might be required for this, as well as for the process of technological assimilation and capital accumulation necessary to have a sufficiently strong industrial structure..." (Prebisch, 1961, vol. II, pp. 94-95).

#### 2. The timing of industrial export expansion to the rest of the world

In his 1964 Report to the Second United Nations Conference on Trade and Development (UNCTAD), Prebisch criticises those that claim that ISI, even

within a common market, is an alternative to the expansion of industrial exports to the developed countries. Instead, he argues, the time has come to pursue them simultaneously.

He identifies limits for further ISI even within a common market for four reasons: i) certain groups of countries in Latin America do not reach a sufficiently large market size for efficient ISI beyond a certain point; ii) the development of a common market requires time, while the inefficiencies of ISI are already present; iii) trade relations with industrial countries, particularly in the area of capital goods, would greatly contribute to technical progress and innovation: "Growing trade (with the industrial centres) has the virtue of helping to rapidly propagate the goods in which technological innovations are incorporated. If developing countries close themselves within their own groups they would be continuously lagging behind in technical progress" (Prebisch, 1964, vol. II, p. 254), and iv) in a regional group there is the risk that small countries would depend too much on larger ones. The only way to avoid this is to diversify exports by trading significantly with the rest of the world.

From this, Prebisch concludes that the right policy is to simultaneously pursue regional economic integration and the promotion of industrial exports to the rest of the world: "There is in this area a clear interdependence. The development of industrial exports to the rest of the world will have beneficial effects on intra-regional trade. In turn, the growth of industrial exports within the region will prepare those industries to better compete with the rest of the world" (Prebisch, 1964, vol. II, p. 254).

Unfortunately, while in his 1959 book (Prebisch, 1959a) we find quite detailed discussions of the concrete instruments and steps to promote the common market, in his later work Prebisch did not go into

details as regards the policy instruments for simultaneously pursuing regional integration *and* promotion of industrial exports to the rest of the world. He reiterates the need for low levels of protection and the periodical reform of the trade regime, but does not discuss in detail these levels nor these reforms. The point remains, however, that since the early 1960s he gave great priority to both regional integration and the need to develop competitiveness and promote industrial exports to the rest of the world: precisely the agenda of most Latin American countries in the 1990s.

### 3. Reform of the trade regime

Mention has already been made of Prebisch's early emphasis on the need for periodic trade policy reform and liberalization to keep protection within moderate levels compatible with efficient ISI. In his contributions to the *Economic Survey of Latin America* of 1948 and 1949 he does not discuss explicitly the desirable levels of protection. There is, however, a discussion of the limits of industrialization, with strong emphasis on the problem of market size and on the need to expand markets through economic integration.

The first extended discussion of protection is found in his 1954 Quitandinha report. The bulk of his argument is a reassertion of the infant-industry argument for protection as an incentive to industrialization. At this stage he insists on the need for the level of protection to be kept within "reasonable" limits. Two basic constraints to the level of protection are considered: first, protection should be set in relation with its function of compensating for the productivity and wage differentials between the centres and the periphery, and second, protection should not be taken beyond the point where it may negatively affect world trade.

Efficiency limits for protection, and the need to liberalize trade regimes, did not become major con-

cerns of Prebisch until the late 1950s and during the 1960s. As seen above, his 1959 book includes strong criticisms of the fact that protectionist policy had been carried too far (Prebisch, 1959a). In a 1959 article published in the *American Economic Review* he insists that "Tariff protection... by itself does not increase productivity; on the contrary, if protection is excessive it tends to weaken the incentive to produce" (Prebisch, 1959b, vol. I, p. 451). In 1964, he returns to this issue and argues that:

"Industrialization based on import substitution has certainly been of great assistance *in raising income in developing countries, but it has done so to a much lesser extent that could have been the case had there been a rational policy judiciously combining import substitution with industrial exports*" [...] "*The excess of protection has isolated national markets from external competition, weakening and even eliminating the indispensable incentive to improve quality and reduce production costs in a private initiative regime.* Thus, it has tended to suffocate enterprise initiative as regards the internal market as well as exports" (Prebisch, 1964, vol. II, pp. 248 and 250).

These warnings notwithstanding, a major lacuna in Prebisch's thinking on this issue is the absence of a social and political analysis of protection, that is, of the interaction between the social groups that benefit from protection and the State's capacity to revise tariffs and incentives. By the 1960s it was clear that far from being rationally planned and adapted dynamically to the new conditions, as Prebisch recommended, the structure of protection in most Latin American countries was the outcome of a myriad of political pressures by interested groups. In most cases rent-seeking won over economic rationality, a lesson that has not been lost and has greatly helped to develop the political economy analysis of policy interventions (Krueger, 1974; Colander, 1984; Meier, 1990).

## V

### The present relevance of Prebisch's thinking

So far, we have done historical justice to Raúl Prebisch's thought and demonstrated, among other points, that he was no simple protectionist. A separate issue concerns the usefulness of some of Prebisch's ideas for present-day discussions of international insertion, export promotion and regional integration. Some aspects of this are selected for comment in this section.

#### 1. Industrialization, selectivity and living standards

In addition to its contribution to relaxing balance of payments constraints on growth, Prebisch's preference for industrialization was based on two essential criteria: the need to break the fundamental asymmetry involved in the differential income elasticity of demand for primary commodities and for manufactures, and the positive externalities of industrialization in terms of propagating technical progress, upgrading work force skills and increasing productivity and living standards in the long term. The discussion of productive transformation strategies in Latin America can be enriched by taking these two criteria of Prebisch and developing their implications under present conditions.

The first criterion emphasizes the importance of promoting investment and developing competitive advantages in high income-elasticity products. Although this criterion does not exclude a number of high income-elasticity agricultural products, in which the periphery has comparative advantage, world trade trends and the experience of Japan and South-East Asia support Prebisch's preference for manufactures. Japan in the 1950s and South Korea in the 1960s successfully used the income-elasticity criterion to guide industrial policy (Shinohara, 1982; Johnson, 1982; Sáez, 1988; Amsden, 1989).

Recently, two separate work teams have developed the methodology and data bases needed to analyse the competitive position of countries relative

to the participation of their export sectors in high world income-elasticity product lines. In its Competitive Analysis of Nations project (CAN), the Economic Commission for Latin America and the Caribbean (ECLAC) developed an approach to competitiveness based on the relative participation of the countries' export sectors in the imports of the Organization for Economic Co-operation and Development (OECD).<sup>9</sup> Two concepts are given specific definitions: positioning and efficiency. Positioning refers to the relative dynamism of an item in OECD imports: it is favourable when the item's participation in those imports increases and unfavourable when it decreases. Efficiency refers to the relative participation of a country in a specific item. The combination of these features makes it possible to distinguish four strategically different situations, as shown in figure 1.

The quality of the international insertion of each country in world trade is thus examined on the basis of its export composition according to this typology. This approach provides not only a rich framework to historically analyse "winners" and "losers" in terms of international competitiveness, but also important insights for prospective analysis and guidance for productive transformation strategies. For our purposes, the point is that this approach constitutes, in fact, a development of ECLAC's and Prebisch's earlier emphasis on centre-periphery asymmetries and the way to overcome them. Based on an adaptation of the export demand elasticity relative to world income criterion, this approach constitutes a useful first approximation (on the demand side) to the issue of how to improve the quality of international insertion.

<sup>9</sup> See Fajnzylber (1991) and ECLAC (1992), chapter V.

FIGURE 1

## Insertion in international trade: positioning and efficiency

		Relative positioning of products	
		Unfavourable	Favourable
Relative efficiency of countries	Low	WITHDRAWAL SITUATION	LOST OPPORTUNITIES SITUATION
	High	VULNERABILITY SITUATION	OPTIMAL SITUATION

Source: F. Fajnzylber, "International insertion and institutional renewal", *CEPAL Review*, No. 44 (LC/G.1667-P), Santiago, Chile, August 1991, p. 140.

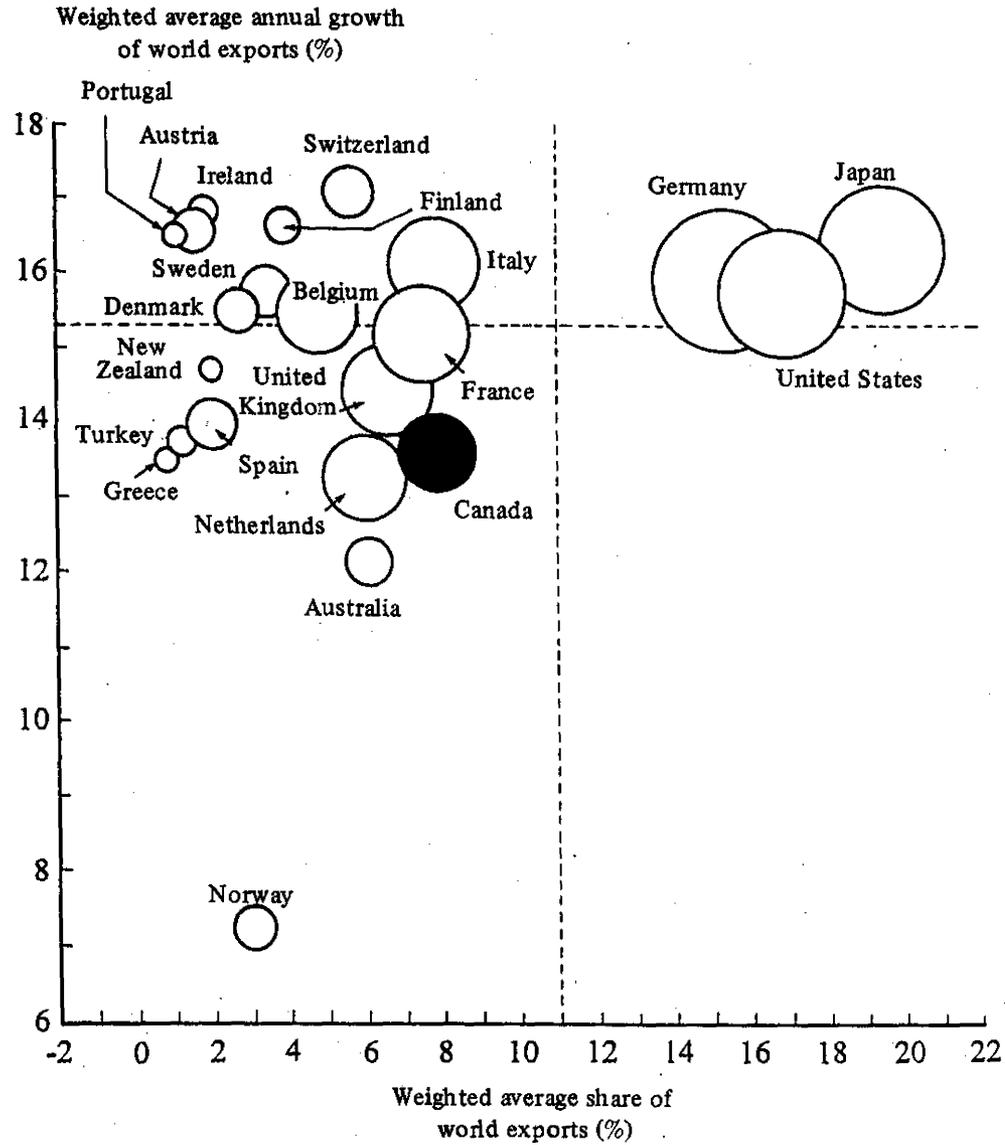
A similar approach has been simultaneously developed by contributors to the *World Competitiveness Report (WCR)*,<sup>10</sup> although probably without being aware of its direct link with Prebisch's concerns. The 1990 WCR includes an analysis of the competitive performance of nations and their industries based on the concept of "national industrial portfolios". For each country, individual "portfolios" are constructed on the basis of export performance in 71 different industries during a number of years. A national industrial portfolio is a description of the overall composition and structure of the industries that operate in a country. The industrial portfolios of 22 OECD countries and 10 newly industrialized nations are given in figures 2 and 3. A growth/share matrix is used, analogous to the one pioneered by the Boston Consulting Group to diagnose the business portfolios of large

corporations. Each country's industrial portfolio is shown as a circle whose area is proportional to the total exports of the country during the period 1985-1989. The vertical axis shows the weighted average annual growth rate of the exports of the 71 industries for each country during that period. A country's position on this axis is determined by the composition of its exports: the extent to which it has specialized in exports from industries whose international trade is growing. The horizontal axis shows the weighted average market share for that country. In this case, the country's position is determined by its success in international trade in the industries that constitute its portfolio. Figure 2 shows clearly that Japan, Germany and the United States are the three leaders in international competitiveness. In terms of both the size and position of their industrial portfolios, these countries are in a group by themselves. Japan's position reflects its extraordinary ability to strategically manage its industrial portfolio. Its position on the vertical axis is a consequence of recent success in shifting out of low-growth industries into those of high growth. Similar success is shown in figure 3, particularly by Hong Kong, Taiwan and Korea. However, a comparison of positions on the horizontal axis shows, as expected, the smaller average market shares of the latter countries.

<sup>10</sup> The *World Competitiveness Report* has been published annually since 1980 in Switzerland by IMD International and The World Economic Forum. The report is based on a quantitative methodology for measuring critical factors of competitiveness. The measurements generate a scoreboard comparing relative competitiveness among OECD countries and among a sample of newly industrialized countries. The concept of national industrial portfolios was developed by Professor Joseph D'Cruz, of Toronto University, Canada, who has contributed with a diagnosis of national industrial portfolios in successive issues of the Report. See D'Cruz (1990) and D'Cruz and Rugman (1992).

FIGURE 2

**PRINCIPAL DEVELOPED ECONOMIES: INTERNATIONAL COMPETITIVENESS, 1985-1989<sup>a</sup>**

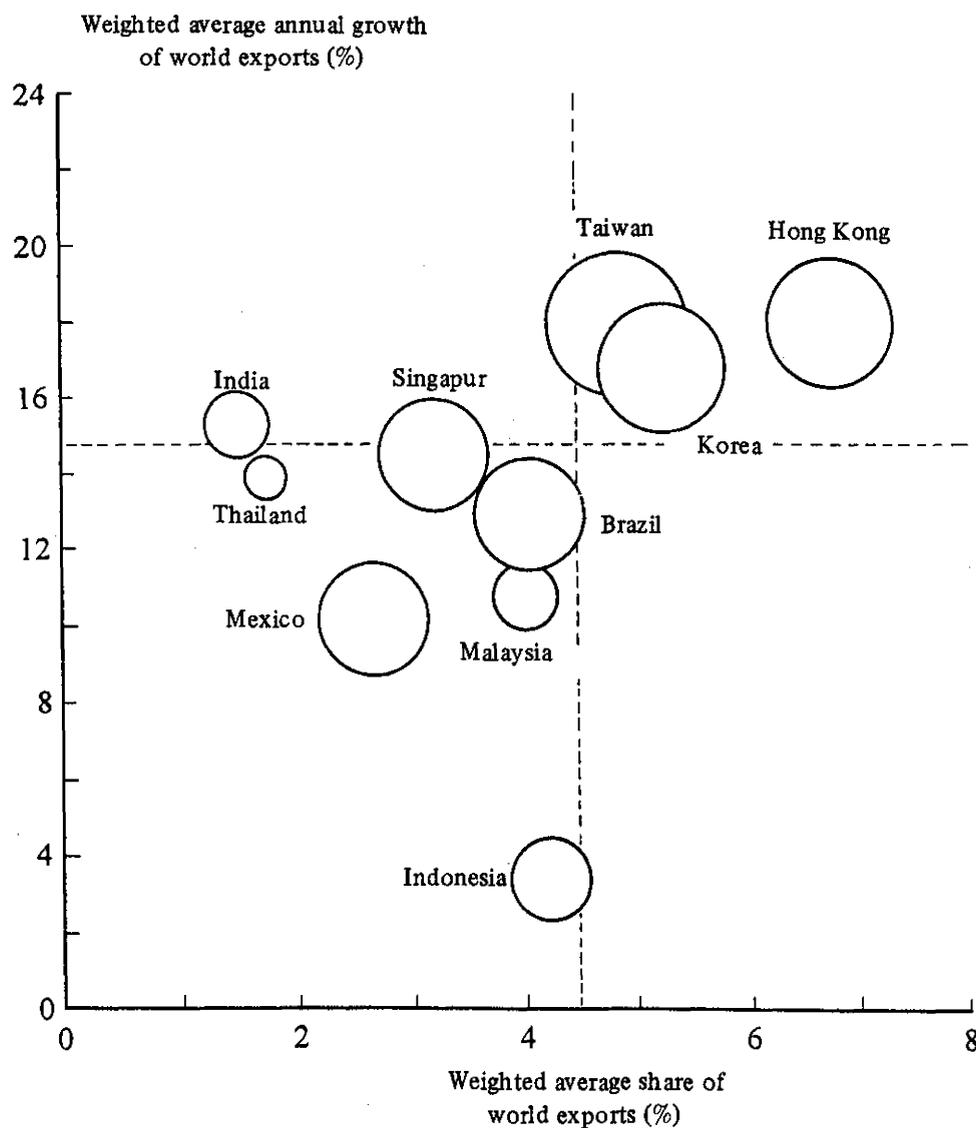


Source: Joseph R. D'Cruz, "National industrial portfolios", *The World Competitiveness Report 1991*, Lausanne, IMD International, and Geneva, The World Economic Forum.

<sup>a</sup> The circles are proportionate to total exports in the period. Weighted average growth: 15.3%. Weighted average market share: 11%.

FIGURE 3

### NEWLY INDUSTRIALIZING ECONOMIES: INTERNATIONAL COMPETITIVENESS, 1985-1989<sup>a</sup>

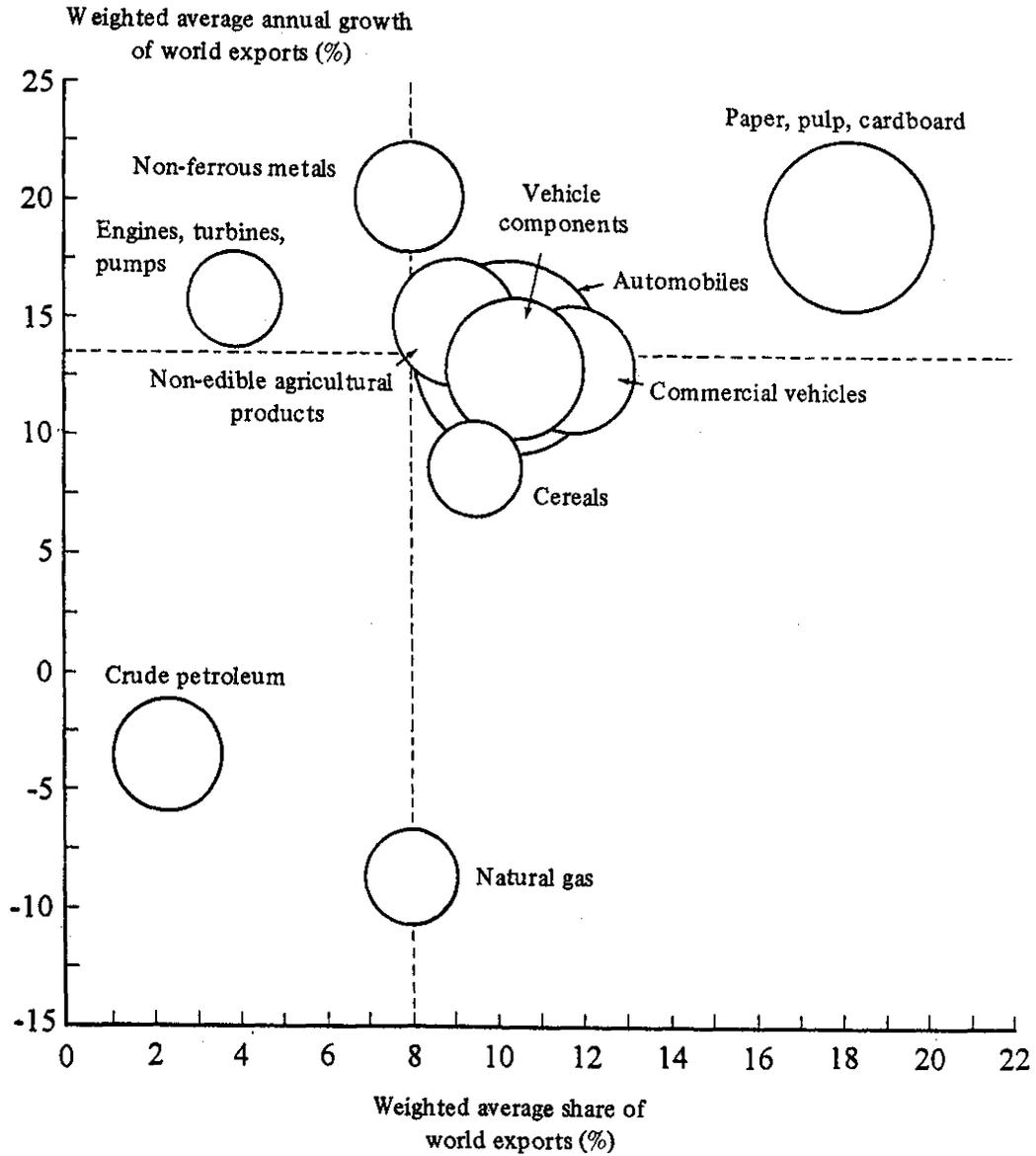


*Source:* Joseph R. D'Cruz, "National industrial portfolios", *The World Competitiveness Report 1991*, Lausanne, IMD International, and Geneva, The World Economic Forum.

<sup>a</sup> The circles are proportionate to total exports in the period. Weighted average growth: 14.7%. Weighted average market share: 4.5%.

FIGURE 4

**CANADA: INTERNATIONAL COMPETITIVENESS OF THE 10 LEADING INDUSTRIES, 1985-1989 <sup>a</sup>**



**Source:** Joseph R. D’Cruz, “National industrial portfolios”, *The World Competitiveness Report 1991*, Lausanne, IMD International, and Geneva, The World Economic Forum.

<sup>a</sup> The circles are proportionate to total exports in the period. Weighted average growth: 13.6%. Weighted average market share: 7.9%.

As an illustration, Canada's industrial portfolio is presented in figure 4 (only the ten most important industries are displayed). In this case each circle shows: i) the relative attractiveness of the industry, as measured by the rate of growth of world markets; ii) the relative competitive position of the country in that industry, as measured by the country's market share, and iii) the relative importance of that industry in that country's portfolio, as measured by the area of the circle.

In conclusion, both of the above-mentioned approaches to the performance and relative competitive positions of countries contain and generalize important elements of Prebisch's concerns with international trade patterns. In particular, they are powerful tools for diagnosing and discussing the quality of international insertion of particular countries and can also be interpreted as modern adaptations and refinements of Prebisch's criterion of export demand elasticity relative to world income. To the extent that countries succeed in shifting their industrial or productive portfolios from low-growth to high-growth industries or product lines, they would be making progress towards eliminating one of the fundamental asymmetries of centre-periphery trade that concerned Raúl Prebisch.

Prebisch's second reason for giving industrialization high priority, initially via import substitution but later through the promotion of industrial exports to the large markets in developed countries, concerned industry's unique capacity to foster technical progress, learning and upgrading of skills, contributing in this way to the fundamental objective of increasing living standards. International experience and industry and country case studies also support the key importance of work force skills in achieving this objective (Freeman, 1987; Amsden, 1989; Porter, 1990).

Present conditions are, of course, very different from those of the 1950s and 1960s, but the strong link Prebisch established between industry, labour skills and long-term living standards remains a crucial issue that is receiving renewed attention. Robert Reich, for instance, has cogently argued that globalization is increasingly producing an international or global labour market, encompassing Asia, Africa, Latin America, Western Europe and increasingly Eastern Europe and the Soviet Union. The standard of living of the nationals of particular countries increasingly depends, according to Reich, not on the

profitability of the corporations nationals own, but on the value national labour forces are able to add to the global economy through their skills and insights (Reich, 1991). This is another theme that deeply concerned Prebisch and that should be reexamined under a new light in the present stage of international insertion into an increasingly global world trade and investment system.

## 2. The concept of reciprocity

Prebisch's treatment of the issue of reciprocity is also of interest for present discussions of regional integration and international insertion. He discussed reciprocity in two contexts: in centre-periphery trade, and in intra-Latin American trade.

### a) *Reciprocity in centre-periphery trade*

Centre-periphery trade asymmetries led Prebisch to conclude that protection has different effects in each region, with important consequences for the way reciprocity should be conceived. The fact that income-elasticity of demand for industrial imports in the periphery is higher than income demand elasticity for primary commodities in the centres implies that:

"Under equal per capita growth rates, industrial import demand in peripheral countries will tend to grow at a higher rate than primary commodities import demand in the centres. If population growth in the peripheral country is higher than in the centre, this disparity in import growth rates will be accentuated. If income growth in the peripheral country is higher than in the centres, the disparity is further intensified" (Prebisch, 1954, vol. I, p. 366).

Therefore, if a peripheral country sets itself to reduce or even to maintain the income disparity with the centres it will have a persistent tendency to balance of payments disequilibrium. Thus, Prebisch argued, maintaining a moderate level of protection in the periphery is a way to correct this bias and limit imports to the level allowed by its payment capacity. Furthermore, as long as protection is kept within limits, it would not reduce the growth of world trade. In contrast, protection by the industrial centres against primary commodity imports from the periphery accentuates the bias and tends to retard development in the periphery and to slow down the growth of world trade.

Conversely, Prebisch argued, the reduction or elimination of protection in the centres has an

implicit reciprocity component, because the resulting increase in the periphery's exports will lead to a correlative increase in its imports of industrial products. This would occur even without tariff reduction in the periphery, due to its higher income demand elasticity for industrial imports. Thus, "The traditional concept of reciprocity, under which peripheral countries are asked to grant duty concessions similar to those granted by the centres, does not take into account this *implicit reciprocity*" (Prebisch, 1959b, vol. I, p. 457).

Prebisch applied this analysis in commenting on U.S. trade policy and observed that:

*"...tariff concessions agreed by the U.S. with developing countries have their own implicit counterpart: the higher international purchasing power generated by higher U.S. imports will tend to turn itself directly and indirectly into a higher international demand for U.S. exports. In reality, the U.S. predicament vis-à-vis Latin America could not be more favourable. As long as these countries maintain protection within limits, it would not be the tariff level but the volume of U.S. imports (from Latin America) that will determine the amount of Latin American imports (from the U.S.)"* (Prebisch, 1954, vol. I, p. 374).

Two observations are relevant on the above analysis. First, Prebisch does not take into account trade in services and capital flows: factors which could contribute to relax the foreign exchange constraint to some extent. He mentions these factors but puts them aside "for simplicity's sake". The sustainability of growth without falling into a binding balance of payments constraint, when trade in services and capital flows are considered, is certainly a major issue at present, particularly for economic management during the transition to liberalized trade.

Second, the practical importance of implicit reciprocity depends on actual trade structures, which increasingly diverge substantially from the postulated centre-periphery specialization. However, particularly in the context of possible U.S. - Latin America free trade negotiations as part of the Enterprise for the Americas Initiative, implicit reciprocity as conceived by Prebisch may provide a strong justification for a differential and prolonged phase-out of tariff and non-tariff barriers for Latin American countries. It is interesting to note that, in relation to the future outward-oriented stage based on reciprocal trade in industrial products with the centres, Prebisch argued that: "Once this objective has been achieved, the

traditional concept of reciprocal concessions might gradually recover its validity" (Prebisch, 1961, vol. II, p. 94).

#### *b) Reciprocity in intra-Latin American trade*

Prebisch was concerned about the low coefficient of intra-regional trade versus total trade in Latin America, and about asymmetries or polarization effects between countries as a source of difficulties for regional economic integration. Reciprocity was conceived as a way to tackle these problems. It required that member country imports be financed by their own additional industrial exports: "It is essential (for the success of the common market) that the country that increases its imports (from Latin America) be able to pay for them by increasing its own industrial exports, in addition to its primary commodity exports. Otherwise, this policy will not promote that country's own industrialization, and it would boil down to transferring to other Latin American countries the foreign exchange that was previously used in paying imports from the rest of the world" (Prebisch, 1959a, vol. I, pp. 499-500).

Reciprocity, therefore, would involve efforts to balance trade in industrial products and promote industrial exports. It was also conceived as a way to deal with the distribution of costs and benefits of integration and ensure the continued commitment of countries to the integration scheme. A number of points should be made in this respect.

First, despite several decades of integration efforts, Prebisch's concern with the low coefficient of intra-regional trade relative to total trade in Latin America is still valid. In fact, a major concern in the approach calling for a move towards a Hemispheric Free Trade Area, as proposed by the Enterprise for the Americas Initiative (EAI), is the need to avoid a hub-and-spoke pattern of trade, with the United States as the hub and very small trade among the Latin American spokes (Wonnacott, 1991; Lipsey, 1992).

Second, under present conditions some trends associated with globalization, such as the growth of intra-industry trade, the new sourcing practices of global enterprises, and the growth of trade in services and in knowledge-intensive activities, suggest the need to redefine reciprocity by moving away from a narrow definition in terms of the balance of trade in industrial products. Nevertheless, the concept of reciprocity remains valuable because it focuses attention

directly on foreign-trade structures and their effects on the pattern of development (Antonelli, 1989; Rowthorn and Wells, 1987).

Third, Prebisch was realistic as regards the difficulties of achieving reciprocity narrowly defined: "The possibility should be accepted, of course, that the competitive strength of certain countries would make their exports dominant in the market of less competitive countries, without the latter being able to correlatively develop their exports. It is essential to prevent this type of situation from provoking restrictive measures" (Prebisch, 1959a, vol. I, p. 500). In order to allow "the smooth functioning of the common market" and prevent restrictive measures, Prebisch discussed in some detail four types of measures which are of interest for present-day regional integration efforts: i) More competitive and advantaged countries should stimulate their own imports from the common market by accelerating the rate of elimination or reduction of their own tariff and non-tariff barriers (NTBs); ii) less competitive countries should receive significant technical and financial cooperation to develop industries and improve competitive advantages; iii) less competitive countries should be assured, by appropriate safeguards, that if despite corrective measures in terms of cooperation and faster liberalization by the more developed countries, their unfavourable situation persists, they would be able to reduce the rate of reduction or elimination of tariffs and NTBs; iv) a multilateral credit facility (clearing house) is recommended in order to save on the use of hard currency and induce countries to commit themselves to deeper liberalization than they would be prepared to do otherwise (Prebisch, 1959a, vol. I, pp. 499-514).

Clearly, these types of measures are relevant not only to Latin American integration, but also, and even more forcefully, to integration into any larger trade bloc. Elsewhere, we have argued that the acute asymmetries between prospective members of a Western Hemisphere Free Trade Area (WHFTA) that includes the U.S., Canada and Latin America suggest the need to exercise asymmetric or relative reciprocity by adopting several policies that are essential to make a free trade area among such a heterogeneous group of countries viable (Salazar-Xirinachs and Lizano, 1992, chap. 2). These include: i) differential phase-out periods for the elimination of tariff and non-tariff barriers; ii) transitional support measures

from the more developed to the less developed member countries; iii) technical and financial cooperation, particularly to upgrade standards (products, processes, the environment, intellectual property); iv) support for improvement of the investment climate and the development of long-term competitiveness (science and technology, training and other factor upgrading policies). The latter would be aimed at accelerating the transfer of technology, improving export services, and removing supply side inflexibilities in the less developed partners.

### 3. Regionalism versus multilateralism

Some analysts fear that the U.S. endorsement of regionalism, the Europe-92 programme, and other regional integration efforts will tilt the balance away from multilateralism and lead to fragmentation of the world trading system (Bhagwati, 1992). Others, however, welcome regional initiatives as a means of delivering locally what seems impossible to attain globally (Krugman, 1992; Summers, 1991; Dornbusch, 1990).

In all his main contributions Prebisch shows a consistent concern with the impact regional economic integration might have on the international trading system and with the limits protection should have in order to avoid adverse effects on world trade. In this respect, he developed a number of related arguments.

First, he argued that in view of the income-elasticity asymmetries, moderate protection in developing countries is necessary to manage the foreign exchange constraint, but this would not affect world trade negatively: on the contrary, to the extent that protection helps to raise income in developing countries it might actually contribute to the expansion of world trade:

*"There are two kinds of protectionism in developing countries. First, protectionism that contributes to promote the structural changes required by economic development without reducing imports below the volume corresponding to external payments capacity and without reducing world trade nor weakening its growth rate. Secondly, protectionism that goes beyond the limits required by import adjustment and that adversely affects world trade"* (Prebisch, 1954, vol. I, p. 368).

In contrast, according to Prebisch, protectionism in the centre would be highly negative to world trade

and to multilateralism: it would seriously affect exports and income growth in the periphery, and would therefore also reduce the centre's industrial exports to the periphery. The dynamism of the world trading system is determined, he argued, by the economic behaviour of the centres, the periphery having basically a passive role. By opening up to the periphery's exports the centres can create purchasing power for their own industrial exports to developing countries. Conversely, if the centres limit their imports, this would reduce foreign exchange earnings and import capacity in developing countries, and would force these countries to intensify their own protectionist policy (Prebisch, 1954, vol. I, pp. 371-373): "*It is beyond doubt that any country, large or small, that resorts to protectionism when it has no disparities to correct in foreign trade elasticities would exert a negative pressure on world trade. The larger the country, the larger its influence and its responsibility*" (Prebisch, 1959b, vol. I, p. 459).

Thirdly, Prebisch insisted that a regional group or common market can greatly help to improve world trade and multilateralism, if it meets certain conditions. A common market, with its large potential for increasing trade in industrial products, "*could break*

*the old patterns of trade according to which each Latin American country orients its trade towards the industrial centres, with very weak trade flows with other countries in the region*" (Prebisch, 1959b, vol. I, p. 460). Two conditions are essential, according to Prebisch, in order to maximize the contribution of regional integration to world trade and multilateralism: efficiency in the industrialization process, which in turn requires protection to be moderate, and a sufficiently large integrated market. As regards the former, cost reductions brought about by the common market would justify a reduction of average tariff levels *vis-à-vis* the rest of the world, in comparison with the alternative scenario of an inefficient ISI process continuing in fragmented markets. Thus, he argued, the common market offers the opportunity to negotiate, as a trade bloc, reciprocal tariff reductions *vis-à-vis* the rest of the world, which would be beneficial for international trade.

As regards the second condition, market size might be insufficient even when relatively small countries integrate. Therefore, for economic integration to render all its potential benefits: "*it should have a multilateral character, and involve the largest number of countries possible*" (Prebisch, 1954, vol. I, p. 379).

## VI

### Final observations

We have shown that, far from remaining locked-in in an inefficient import substitution industrialization path, for Prebisch, gradual and negotiated incorporation into increasingly wider commercial relationships was seen as the key to economic progress. Regional economic integration and periodical revisions of external tariffs to keep protection within moderate levels were essential ingredients for reaching a stage of reciprocal trade in industrial products with the centres, which Prebisch considered as the only option capable of breaking the centre-periphery asymmetries, increasing income and employment, and raising living standards in developing countries. Thus, rather than departing from Prebisch's long-term vision, the current search for a new high-quality international insertion and the integrationist revival in Latin America may be interpreted as a reassertion of the

sequence of policies originally envisaged and recommended by Prebisch.

In addition, Raúl Prebisch's ideas on economic integration, outward-looking growth based on industrial export promotion, selectivity based on world income-elasticity criteria, and reciprocity, appropriately adapted to present conditions, are relevant for the rethinking of the strategy of international insertion complemented by regional integration in which Latin American countries are presently busily engaged.

We have not argued, however, that the present-day case for international insertion and regional integration is based on exactly the same reasons Prebisch had in mind. New reasons for regional economic integration and cooperation emerge when integration is seen as functional and complementary to

international insertion: a topic which has been analysed elsewhere.<sup>11</sup> The characteristics of the world economy and of Latin America are now very different from those of the 1950s and 1960s. We now live in the context of a different "technological paradigm". Globalization, the increasing importance of trade in services, the move from the high-volume to the high-value enterprise based on knowledge and information-intensive activities, and new sourcing practices of global firms are all features that are fundamentally changing the international and local economies and that should be taken into account. In particular, the relative attractiveness of countries as locations for investment emerges as a major issue in the analysis of international insertion strategy and its domestic policy requirements. What we have tried to show is that, in addition to the validity of his overall long-term vision of the development process, a number of Prebisch's specific concerns are relevant today:

i) The income-elasticity criterion is a useful approach for assessing the relative competitive positions of countries and guiding productive modernization policies to improve the quality of international insertion.

ii) The link between labour skills and living standards remains a crucial issue that is receiving renewed attention.

iii) Prebisch's concern with the low coefficient of intra-regional trade compared to total trade in Latin America is still valid, despite decades of inte-

gration efforts, and assumes renewed importance in the context of the formation of a Western Hemisphere free trade area.

iv) Economic integration as a means of relaxing the foreign exchange constraint is a controversial proposition when trade in services and capital flows are taken into account. However, sufficiently large capital inflows over time to sustain growth are a sensitive issue for economic management during the present transition to freer trade in Latin America, and Prebisch's point remains valid: by deliberately promoting economic integration, countries could significantly raise their rate of growth and industrialization.

v) Existing trade asymmetries between prospective members of economic integration areas strongly suggest the need to give practical meaning under present conditions to Prebisch's concept of relative reciprocity and to complementary policies to ensure the viability and fairness of free trade areas that integrate countries at very different stages of development.

vi) Finally, also relevant today are the two essential conditions Prebisch emphasized in order to maximize the contribution of regional integration to freer world trade and multilateralism: efficiency in the industrialization process, which in turn requires protection to be moderate, and a sufficiently large integrated market. Moderate protection, in addition, reduces the trade-diversion costs of integration.

(Original: English)

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<sup>11</sup> See ECLAC (1990) and Salazar-Xirinachs (1993).

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# Trade liberalization *in Latin America*

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A major shift has been observed in the development strategies of most of the Latin American countries in recent years. One sign of this change has been that the countries have increased the neutrality of their trade policy incentives in an effort to give greater priority to the market as a resource-allocation mechanism; it is also hoped that this will result in a more export-oriented production apparatus. The authors review these changes and, in assessing the results to date and the consistency of these policy packages, contend that their impact in terms of economic growth and changing production patterns has thus far been unpromising. Indeed, generally speaking, the countries' performances as regards capital formation and overall productivity have not been satisfactory. A number of recommendations are also made regarding other measures that could complement existing policies aimed at opening up the region's economies in a way conducive both to changes in production patterns and to development.

# I

## Towards a new development strategy?

In recent years, many Latin American countries have embarked upon trade liberalization drives. This article reviews the radical changes in trade policy which this has entailed, together with these processes' current and foreseeable results, and offers some preliminary recommendations regarding possible complementary measures.

The first sustained experience with trade liberalization was in Chile, which launched a process in the 1970s that, by the end of that decade, had made its economy one of the most open in the entire world.

By the mid-1980s, after more than half a century of protectionism, a tendency towards radical change in the countries' development strategies and policies was becoming evident. As early as 1983 Costa Rica set out on a gradual transition from the import-substitution model it had been implementing at the national and Central American levels to a model oriented towards forging a more dynamic position in the international economy, with emphasis on extra-regional markets. Then, in 1985, Bolivia and Mexico started up relatively fast-paced liberalization programmes of their own.

In the early 1990s, several other countries joined in this movement, including Argentina, Brazil, Peru and Venezuela. Even Colombia, which had undertaken a gradual programme in 1990 to open up its economy over a four-year time span, decided to step up the pace of its liberalization effort midway through 1991 so that it could be completed in 1992. Thus, although they were moving forward at different speeds, it was clear that the countries of the region had reached a major turning point.

Explicitly or implicitly, each country had to decide how to go about the business of liberalization, what to liberalize and what not to, how much, in

what sequence, and what other policies it should adopt to ensure that its liberalization process would contribute to its development (see section II). In this article we will attempt to come up with some preliminary answers for those questions based on recent events in Latin America.

Later on in this essay (see section III), we will review a portion of the voluminous literature on Asia's export-oriented economies (the Republic of Korea, the Chinese province of Taiwan and, more recently, Indonesia, Malaysia and Thailand) so that Latin America's more recent experiences can be compared with other experiences of a longer standing and very different character. The greatest differences between the liberalization efforts of the Latin American countries and the way in which the Asian countries have opened up their economies are that most Latin American liberalization programmes have been carried out rapidly and the State has played a passive role in those programmes, whereas the opening of the Asian economies has been a long, State-led process involving the construction of a production apparatus oriented towards international markets.<sup>1</sup> When imports were liberalized in Asia, the economy's structural transformation had already been accomplished and exports had been on the rise for a long time. These conditions were buttressed, in most cases, by macroeconomic equilibria and much higher investment rates. In contrast, the drastic import liberalization programmes carried out in Latin America were launched during the initial stage of the countries' internationalization strategies and often coincided with stabilization processes and low rates of capital formation.

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<sup>1</sup> In this article we will make use of the distinction drawn by Damill and Keifman (1992) between "opening" and "liberalization". The former concept applies to a policy package designed to orient an economy towards international markets as part of an export-led process. The latter refers only to the dismantling of protective barriers and other government controls as part of an import-led process.

Some of the key elements of these reform programmes will be examined later on in this analysis (see section IV) in the light of the conditions required in order to open up an economy in a way that will stimulate its long-term development. Clearly, in the world of today, international competitiveness and a more dynamic position in international markets must be achieved in order to permit sustained development. Therefore, restrictions on imports must be reduced. Regardless of whatever benefits it may have provided on the domestic front, the old sort of protectionist policy is undoubtedly an obstacle to development.

The basic problem with the protectionist policies of the past was that, in the final analysis, policy-makers did not know what they were promoting or why (Ffrench-Davis, 1986). As noted by Fritsch and Franco (1993, p. 32), in addition to the fact that it is very costly, comprehensive protection may ultimately end up not protecting anything in particular. The protectionist policies of the past, both in Latin America and in other regions, were often exploited by private concerns seeking to turn an easy profit. In many cases no social benefits were evident, and the resulting industrial structures tended not to be competitive on the international market and to continue being dependent on government protection indefinitely. It should also be recognized, however, that these schemes permitted the establishment of industrial sectors that have served as the basis for a subsequent form of development which is more strongly oriented towards international competitiveness than before.

In order for trade reforms to be successful, the value added by the creation of new activities must exceed the value subtracted by the destruction of existing activities. This means, in other words, that the increase in exports must be greater than the decrease in import substitution;<sup>2</sup> that export activity

must have positive spillover effects on the rest of the economy, which will depend upon those exports' degree of diversification and the amount of value added they contain; and that international competitiveness must be attained through a continuing increase in productivity rather than by means of low wage levels and rising subsidies or tax exemptions.

This is why it is essential to open up an economy in a way that will not entail the indiscriminate destruction of existing installed capacity and that will permit an effective retooling of production activities. This process also needs to be coupled with a sustained, credible change in relative prices favourable to the production of export products and with the improvement or creation of the markets and institutions essential to a steady increase in productivity through vocational training, improvements in infrastructure, incentives for technological innovation, the development of long-term or productive investment-oriented capital markets, and an increased ability to negotiate access to external markets.

This focus has not, generally speaking, been the primary one chosen by Latin American countries launching trade liberalization initiatives, since most of them have embarked upon this course of action without the benefit of a strategy for achieving a more open economy. This approach suffers from serious shortcomings in three crucial areas. First, unilateral bids to open up an economy would make sense in an open, dynamic, competitive world economy, but are less advisable in an international economy where protectionism is still a very real factor, trade is growing slowly, and a strong trend towards the formation of regional trade blocs is to be observed. Second, this process is based on static comparative advantages and short-term gains in resource allocation, but it becomes vulnerable if it is concentrated in areas of activity whose markets are more sluggish and less active in terms of technological innovation. Third, in financial markets and on the capital account of the balance of payments, the recent move towards market deregulation has hampered the reallocation of resources which was supposed to be brought about by the liberalization of trade because, under the conditions prevailing in the 1990s, it has been conducive to sharp increases in exchange rates and high interest rates. These factors discourage the productive investment needed to bring about structural change and cause resources to be concentrated in purely financial investments.

<sup>2</sup> This does not mean that the option of import substitution should be discarded. The larger the domestic market in question, the greater the potential scope of import substitution. This is attested to by the fact that the exports of countries such as the United States and Japan represent no more than 10% and 15%, respectively, of their GDP. What is truly new about the development strategy that is now taking shape is the idea that firms producing goods and services, whether for the domestic or international market, must become increasingly competitive during the learning period. This is done, in part, through exposure to outside competition and the achievement of export, investment and technological development targets.

## II

### Trade liberalization programmes in Latin America

Many countries in the region have undertaken trade liberalization reforms in recent years (see table 1). Eight of the nine countries shown in table 1 –all except Costa Rica– introduced reforms that could be described as drastic and sudden. Moreover, in seven of these eight countries –in this case the exception is

Chile– the liberalization of imports was carried out within a period of just two or three years (1989-1990 to 1992-1993). Argentina implemented the bulk of its liberalization programme in April 1991. In Chile, the process took five and one-half years (from late 1973 to mid-1979).

TABLE 1

Latin America (nine countries): overview of trade liberalization process

Country	Start of liberalization programme	Maximum tariff		Number of tariff lines		Average tariff		Non-tariff barriers	Variation in real exchange rate <sup>a</sup>
		Initial	End 1992	Initial	End 1992	Initial	End 1992		
Argentina <sup>b</sup>	1989	65	30		8	39 <sup>c</sup>	15 <sup>c</sup>	In 1988 the value of industrial output subject to restrictions was reduced from 62% to 18%. In 1989-1991 non-tariff barriers, additional temporary duties and specific duties were eliminated.	-40
Bolivia	1985	150	10		2	12 <sup>d</sup>	7 <sup>d</sup>	All but a few bans and import permit requirements were discontinued.	134
Brazil	1990	105	35	29	7	32 <sup>e</sup>	21 <sup>e</sup>	In 1990 the list of prohibited import products and advance permit requirements were eliminated. National content requirements applying to intermediate and capital goods will be maintained, however	31
Colombia <sup>b</sup>	1990	100	20	14	4	44 <sup>d</sup>	12 <sup>d</sup>	Virtually all advance permit restrictions were eliminated in late 1990.	1
Costa Rica	1986	100	27			27 <sup>e</sup>	20 <sup>e</sup>	Import permits and other restrictions are to be phased out over the period 1990-1994.	4
Chile <sup>f</sup>	1973	220	10	57	1	94 <sup>e</sup>	10 <sup>e</sup>	Quantitative restrictions on imports were eliminated in the 1970s.	-10
	1985	35	11	1	1	35 <sup>e</sup>	11 <sup>e</sup>	Price bands were reintroduced and an anti-dumping system was established.	0
Mexico	1985	100	20	10	3	24 <sup>e</sup>	12 <sup>e</sup>	The coverage of import permit requirements was cut from 92% in June 1985 to 18% by December 1990, and the system of official import prices was discontinued.	-9
Peru <sup>b</sup>	1990	108	25	56	2	66 <sup>e</sup>	18 <sup>e</sup>	In September 1990 import permits, controls and authorization requirements, quotas and bans were all eliminated.	-21
Venezuela	1989	135	20	41	4	35 <sup>d</sup>	10 <sup>d</sup>	The number of items subject to restrictions has decreased from 2 200 in 1988 to 200 at present. Specific duties, which in some cases had raised the tariff ceiling to 940% prior to the liberalization programme's implementation, were eliminated.	7

Source: ECLAC, on the basis of figures provided by the countries.

<sup>a</sup> From the initiation of the liberalization programme until 1992; the exchange rate applying to exports has been used.

<sup>b</sup> Tariffs include surcharges. <sup>c</sup> Weighted by domestic production. <sup>d</sup> Weighted by imports. <sup>e</sup> Simple average of tariff positions.

<sup>f</sup> Chile's first trade liberalization programme was completed in 1979, and a uniform 10% tariff was in effect until 1982. The first row of figures therefore refers to that period (1973-1982). The second row gives information on the reduction of import duties, which, after having been raised to 35% in 1984, were brought down to 20% (1985), 15% (1988) and then to 11% (1991).

In all cases, albeit to varying extents, quantitative restrictions have been dismantled and tariffs have been lowered significantly. Generally speaking, the amount of tariff protection provided differs considerably from its pre-reform levels, and the spread of rates of effective protection has diminished substantially. No country has yet adopted a tariff rate of zero, however, and only Chile has a uniform tariff (currently 11%). Bolivia is close behind it with a tariff system having just two brackets and a 10% maximum. All the other countries have a number of different tariff rates with ceilings ranging from 20% to 40% and average rates of between 10% and 20%. These regional trends in trade policy have been complemented by a trend towards the conclusion of bilateral or multilateral free trade agreements covering a wide spectrum of tariff items whose provisions are not confined to the reduction of tariffs on individual products (Lahera, 1992).<sup>3</sup>

In a number of countries, trade liberalization measures have been accompanied by the liberalization of the balance-of-payments capital account. Under the conditions prevailing since the start of the 1990s, when international capital markets began to take a positive view of the Latin American countries once again, the liberalization of the capital account has prompted considerable increases in currency values (Calvo, Leiderman and Reinhart, 1993; ECLAC, 1992a) just when trade reforms urgently required a decline in those values. Some countries (Chile and Colombia) have been more successful than others in countering upward pressure on their currencies, but in order to do so they have had to resort to exchange controls and other heterodox forms of "financial engineering".<sup>4</sup>

In the following section we will examine the reforms recently implemented in three countries of the region within the frame of reference set out above. These three countries have been chosen be-

cause their reforms have been in place long enough for the effects to be reflected in economic performance (Chile, Mexico and Bolivia), thereby providing a basis for an evaluation of their impacts on growth and investment.

### 1. The frame of reference for an analysis of international economic positioning strategies

Trade reforms are usually undertaken as part of a broad-ranging process of change in which international competitiveness and exports play a leading role. The main instrument of reform has been a somewhat indiscriminate and rapid liberalization of imports. The aim is to expose producers of importables, which have often been receiving a high level of protection until then, to outside competition. It is hoped that this will result in higher productivity, less inefficiency, the absorption of new technologies and increased specialization. Producers that do not adapt to outside competition will be pushed out of the market, and the resources freed up by their displacement will be swiftly absorbed by other activities, primarily in the production of exportables.

Exports are encouraged, indirectly, by the reduced cost and wider range of importable inputs which thus become available and by the decline in the local currency's value which the liberalization of imports will tend to prompt in the exchange market.

The reaction of import-substituting activities will depend on how much relative prices change, how swift the change is and how well the relevant producers are able to adjust. It is best if producers can be given the time they need to restructure, but no more than is strictly necessary, so that they will actually be prodded to change. For example, if a tariff is redundant, all the slack can be eliminated very quickly, but the reduction of effective protection should be paced to allow producers to introduce innovations, increase their level of specialization and reallocate their resources. The pace of the adjustment will depend on the credibility of the timetable for change and on how much access producers have to the resources they will need in order to restructure. This will determine whether exposure to competition will be a creative or destructive process.

The reaction of export sectors will depend on how much use they make of importables and on how such goods were dealt with in the pre-reform trade system. Often, imports of inputs and capital goods by

<sup>3</sup> Up until June 1990, the mainstream opinion was that integration accords should be of a partial, very limited scope, along the lines of the Latin American Integration Association (ALADI) agreement in force at the time. The majority view was that trade blocs were inefficient and hindered world trade. President Bush's Enterprise for the Americas changed all that, however, and concerns about trade diversion now appear to have been entirely forgotten.

<sup>4</sup> Regarding the case of Chile, see Agosin, Fuentes and Letelier (1993); on recent measures to avert an appreciation of the currency in Colombia, see Cárdenas and Barrera, 1993.

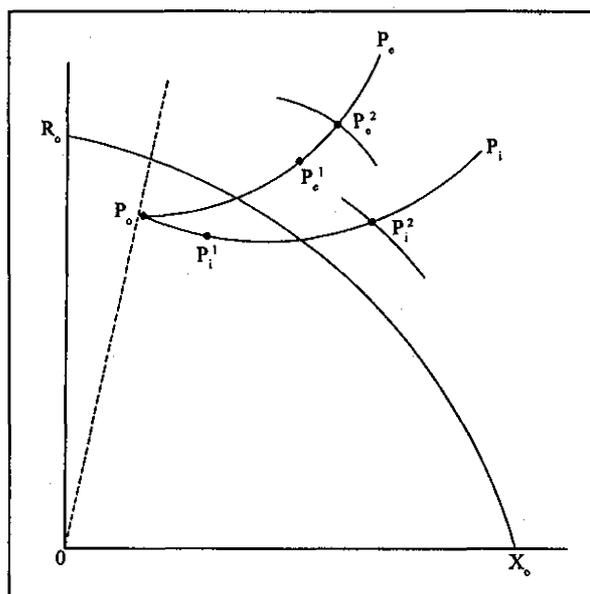
exporters have benefited from some type of exemption from customs duties, but in some cases exports have been discouraged by inoperative or arbitrary import systems.

The movement of the real exchange rate will be a decisive factor in determining the response of production (both of exportables and importables). In order for a reform effort to be successful, the net effect of the changes it makes in incentives must be to boost the production of goods that can be traded on the international market. The ability to restructure will also depend on the overall dynamism of investment and technological innovation, the supply of trained manpower, the operability of the domestic capital market, the existing infrastructure and the extent of access to external markets.

The combination of changes in relative prices, in their credibility and graduality and in the macro- and meso-economic context for the implementation of reforms will determine whether their effects on resource allocation will be predominantly positive or negative. There are two possibilities: the restructuring process can start out with an expansion of the production frontier—as has occurred in the newly industrializing economies (NIES) of Asia—or it can begin with a drop in economic activity and form part of an adjustment process that takes place behind the production frontier (see figure 1).

FIGURE 1

**Asia and Latin America: schematic outline of two trade reform options**



In figure 1, the  $X$  axis represents the value added during the production of exportables and the  $R$  axis (the sum of importables and non-tradables) represents the rest of GDP.  $R_0X_0$  is the initial frontier and  $P_0$  is the starting point for production, behind the frontier, which entails a low export coefficient and some degree of inefficiency in resource allocation. Within the framework of a dynamic expansion of the production frontier, the reforms should bring effective production closer to that frontier and should shift the production mix towards a larger percentage of exportables.

In an export-led internationalization strategy in which the liberalization of imports plays no more than a secondary supporting role—as in the case of the dynamic economies of Asia—the adjustment process will tend to follow a path such as that described by the curve  $P_0P_e$ . This curve denotes a more than proportional increase in  $X$  together with a moderate growth rate for  $R$  within the context of an expanding production frontier and a gradual increase in the efficiency of existing business enterprises. Thus, the economy is positioned on or near a steadily expanding production frontier.

The curve  $P_0P_i$  denotes a different strategy, similar to that used in Latin America; this approach is led by the liberalization of imports and involves the bankruptcy of a significant portion of import-substituting concerns together with a gradual rise in exports. These “dis-substitution” pressures predominate during the early stages of the process, and the economy will therefore be positioned behind the production frontier, which will, moreover, remain stationary during the initial years of the reform.

It is possible that, with this second strategy, the firms that survive will tend to be, on average, stronger and more dynamic than in the first case. During the early years of the adjustment, however, the production resources available and in use will be fewer, owing to the higher rate of bankruptcies and of downscaling; the underutilization of resources will thus be greater, and the stimulus for total investment will be weaker. Therefore, a higher degree of microeconomic efficiency will tend to be combined with a lower degree of macroeconomic efficiency. The hysteresis of the process dictates its end result, since what happens during the transition will have a decisive effect on the level of well-being and on the production structure that emerges upon the completion of the adjustment process.

Of course, there is room for a large number of variations on these two options in the process of changing production patterns. Even within each product category, different intertemporal trends will probably be observed. There will also be crossovers between categories: import-substituting enterprises may be converted either entirely or partially into importers, or, in response to the reforms, may become exporters (Katz, 1993). For the purposes of this discussion, however, we have focused on two sharply differentiated cases in an effort to characterize two opposing styles of internationalization. Figure 1 illustrates these two alternative strategies, whose paths and final end points are represented by the points of production  $P_i^2$  and  $P_e^2$ . Both exhibit sharp increases in  $X$  but very different results for  $R$ . The point  $P_e^2$  is associated with economies such as those of Japan, the Republic of Korea and the Chinese province of Taiwan, whose GDP has shown strong growth for an extended period of time and which maintain an  $X$ -led position in the external economy. In the 1960s and 1970s, Brazil's growth curve was characterized by a more even rate of expansion in  $X$  and  $R$  (in the vicinity of the prolongation of  $OP_0$ ). Chile's situation, on the other hand, is depicted more accurately by  $P_e^2$ , with a steep increase in  $X$  but the stagnation of  $R$  as compared to  $P_0$ : between 1981 and 1989,  $X$  rose substantially (a 51% increase in exports of goods and services per capita) whereas  $R$  climbed slowly in absolute terms and actually decreased in per capita terms (the production of importables rose while the production of non-tradables declined). Towards the end of the process, however, rapid growth is seen in  $R$  as well (as occurred between the late 1980s and 1993).

## 2. Chile

Chile's trade liberalization scheme is the oldest and the longest continuously-applied programme in the region. In late 1973, before the introduction of reforms, Chilean foreign trade was subject to a great deal of government control: nominal tariffs averaged 94% and ranged from 0% to 750%; 50% of all imports had to be authorized by the Central Bank; countless non-tariff barriers were in place, including the requirement of large advance deposits for 60% of all imports, and a complicated multi-rate exchange system was in use involving eight different official exchange rates, with a 1000% difference between the lowest and the highest (Ffrench-Davis, Leiva and Madrid, 1991; Meller, 1992).

(i) *The sweeping reforms of the 1970s.* As part of a far-reaching scheme for handing over the vast majority of economic decisions to market forces, in 1973 trade policy reforms were launched which covered everything from the elimination of all non-tariff trade barriers and the reduction of tariff levels to the establishment of a single exchange rate. Although it was not one of the programme's initial goals, by June 1979 a low, uniform tariff (10%) had also been established.

During the first two years of the trade liberalization programme, real devaluations of the government-controlled exchange rate offset the reduction in the average nominal level of protection (see table 2).

TABLE 2  
Chile: average tariff and real exchange rate, 1973-1992

Year	Average tariff <sup>a</sup> (percentages)	Real exchange rate <sup>b</sup> (1980 = 100)	
		All countries	Excluding Latin America
1973	94.0 <sup>c</sup>	-	110.0 <sup>c</sup>
1974	75.6	-	115.2
1975	49.3	-	156.2
1976	35.6	-	126.6
1977	24.3	-	105.6
1978	14.8	-	117.2
1979	12.1	-	114.6
1980	10.1	-	100.0
1981	10.1	-	85.0
1982	10.1	-	98.7
1983	17.9	-	118.5
1984	24.4	-	122.0
1985	25.8	-	152.2
1986	20.1	171.8	171.8
1987	20.0	179.2	179.0
1988	15.1	191.0	186.1
1989	15.1	186.6	174.9
1990	15.1	193.6	170.4
1991	13.1	182.8	164.2
1992	11.1	168.2	152.0

Source: Ffrench-Davis, Leiva and Madrid (1991) and Central Bank of Chile.

<sup>a</sup> Simple average, excluding preferential arrangements such as those negotiated with the Latin American Integration Association (ALADI) and Mexico.

<sup>b</sup> The external price index used for the heading "All countries" was constructed on the basis of the following countries: Argentina, Brazil, Canada, Germany, Italy, Japan, Peru, Republic of Korea, Spain, United Kingdom and United States. The heading "Excluding Latin America" omits Argentina, Brazil and Peru. For the years up to 1985, the information was taken from Ffrench-Davis, Leiva and Madrid (1991); from 1986 on, it was obtained from the Central Bank of Chile. For methodological reasons, under the "All countries" heading information is presented only from 1986 on.

<sup>c</sup> December 1973.

This gave a strong boost to exports other than copper and afforded some protection for the more efficient import-substituting activities. In 1976, however, the overall direction of the fluctuations in the real exchange rate began to indicate the presence of a lag. One of the reasons for this was that the main focus of exchange policy gradually shifted away from support for the opening up of the economy and towards inflation control. This trend reached its height in 1979 when the nominal exchange rate was fixed in an effort to find a rapid way of bringing domestic inflation closer to the international rate.

The move to open up the capital account, in combination with the international capital markets' high level of liquidity, constituted another reason for the appreciation of the currency. Beginning in 1977, quantitative limits on borrowing by Chilean banks for the purpose of making local-currency loans were gradually relaxed (and, in fact, eliminated altogether by mid-1979). Restrictions regarding minimum borrowing terms were also reduced until these, too, were eliminated entirely in 1982. The heavy inflow of foreign capital to Chile, where local-currency interest rates were considerably higher than the rates being quoted on international markets, buoyed up the real appreciation of the peso (Ffrench-Davis, Leiva and Madrid, 1991).

Interestingly enough, in 1979, when the trade liberalization drive was brought to completion and a uniform 10% tariff was established, the real exchange rate was at almost the same level as it had been at the start of the liberalization process in 1974. Although there was a great deal of slack in the average nominal tariff (94%) existing at the start of the liberalization process and the amount by which domestic prices exceeded international prices was certainly smaller, the fact remains that such a sharp reduction in tariffs was unprecedented in Latin America. Basic trade policy theory would have indicated a need for a compensatory devaluation, but policy-makers actually did just the opposite. In the three years following the completion of the import liberalization programme, the rise in the currency's value accelerated, and this had a severe dampening effect on the production of tradable goods (Ffrench-Davis, 1986).

(ii) *Rectification of the reforms in the 1980s.* The domestic and balance-of-payments crises that hit the country in 1982 as a result of a combination of errors in economic management and three severe external shocks (the suspension of external credit, an increase

in interest rates and a drop in copper prices) caused aggregate demand to fall by 27% and GDP to shrink by over 15% between 1981 and 1983. In an effort to cope with the crisis, a number of separate devaluations were instituted beginning in 1982 and, later on, a crawling peg was reintroduced. Between 1981 and 1988, the real price of the United States dollar rose by 119%. At the same time, the tariff rate was raised in stages up to a level of 35% in September 1984 (with annual averages of 24% in 1984 and 26% in 1985). Starting in March 1985, as the severe shortage of foreign exchange eased, the tariff was gradually lowered again, reaching 11% by mid-1991.

Following the crisis, trade policy became more flexible in various ways. One aspect of this change was that the Government began to make active use of anti-dumping measures to protect the economy from unfair trade practices. To this end, the tariff was raised again to a maximum of 35% (the level to which Chile had committed itself under the terms of GATT in 1979) on imports that Chile could prove were being dumped. In addition, a certain price range, which could be altered if necessary to keep it in line with international price trends, was set for three agricultural products (wheat, sugar and oil-seeds); this also constituted a departure from the uniform tariff level. With regard to exports, the system of drawbacks was refined and a simplified system was adopted for minor exports; under this system, such exports are eligible for a refund of up to 10% of the value of the export so long as total exports of the corresponding tariff item do not exceed a certain annual maximum (currently set at US\$20 million).

(iii) *Contrasts between the two reform programmes.* In summary, Chile has carried out two different trade reform programmes: a radical reform in 1974-1979 and a moderate reform package in 1985-1991. While it is true that the basic characteristics of the country's trade policy—in terms of the discontinuation of non-tariff trade barriers and the institution of a uniform tariff—have not changed since 1979, it should be remembered that the tariff had once again become relatively high by 1984 and was, in addition, accompanied by anti-dumping measures and the price bands mentioned above. In fact, the tariff level averaged 20% in 1984-1989, which was double the average rate for 1979-1982. The greatest difference, however, was that during the first liberalization drive the exchange rate had decreased in the beginning but thereafter rose steadily. During the 1980s, on the other hand, the reduction of the tariff from its maximum level of 35% in September 1984 to 11% by

June 1991 (its present level) was accompanied by a sharp real depreciation (associated with the debt crisis). This sent out positive signals to exporters while at the same time far outweighing the tariff reduction's slight negative effect on the production of goods that competed with imports. As a result, during the second liberalization programme the production of exportables grew more steadily. Unlike the first liberalization effort, however, it was also coupled with a strong upturn in the production of import substitutes, especially between 1984 and the end of that decade.

This more pragmatic approach has left its mark on exchange policy and the balance-of-payments capital account as well. Since 1987, Chile has had to cope with another influx of external capital; however, whereas a prolonged rise in the currency's value was permitted during the first liberalization programme, in keeping with the country's increasingly liberal policy regarding private capital flows, in mid-1990 an effort was mounted to curb the peso's appreciation in order to safeguard the growth prospects of producers of internationally tradable goods. To this end, policy emphasis has shifted away from unlimited entry for capital inflows and an effort has been made to hinder international arbitrage of interest rates. The Central Bank now uses a crawling peg whose point of reference is no longer the dollar but rather a basket of currencies. This basket is used to determine the central rate for the United States dollar, which is allowed to fluctuate within a 20% band and is thus subject to a dirty float. As regards capital flows, short-term external credits are subject to a reserve requirement (currently set at 30%). These policies have curbed the real upward trend in the currency which began early in 1988 and strengthened between January 1991 and late 1992 (Agosin, Fuentes and Letelier, 1993).

If we are to draw any conclusions from Chile's experience (Ffrench-Davis, Leiva and Madrid, 1991), one of them must certainly be that the second reform programme yielded better results than the first. The first was begun during a deep depression (1974-1975) and ended in another (1981-1982). Both crises were associated with severe external disturbances whose internal effects were exacerbated by the dogmatism with which the liberalization of the economy's external sector was implemented and by the confusion that surrounded the programme's goals and the policy tools required to achieve them.

During the first trade liberalization programme, sharp tariff reductions and the dismantling of quantitative controls appear to have had a greater

impact on export growth than the much more modest tariff reduction of the second programme; in the first case, the trade reform initiative's point of departure was one in which the domestic prices of current (consumer and intermediate) importable products<sup>5</sup> were not pegged to international prices; consequently, there was an enormous amount of room in which to reduce costs through the substitution of nationally-produced inputs for imported ones and an abundance of opportunities for bringing about changes in relative levels of profitability. The fact remains, however, that because of the recessionary situation in which these reforms were instituted, their suddenness, and the nature of the trends exhibited by the exchange rate and interest rates, the export sector's strong performance was achieved at an extremely high cost and its dynamism was not transmitted to the rest of the economy; indeed, per capita GDP (as measured by comparing its 1974 and 1981 highs) grew by less than 1% per year; investment was far below its historical levels and the economy fell victim to a rapid process of de-industrialization (see table 3).

In 1984 the Chilean economy began to recover and then went on to achieve sustained growth based on an expansion of exportable supply in non-traditional sectors. The primary reason for the strong performance turned in by non-traditional exports was not the reduction of the country's tariffs, however, since tariffs were lowered by a quite moderate amount and a system of drawbacks was in place for exporters.

During the second liberalization drive, the depreciation of the currency was the main reason for Chile's export success (Agosin, Fuentes and Letelier, 1993), as the real exchange rate more than doubled between 1981 and 1988. The role played by foreign direct investment (FDI) in that export performance was also a fundamental factor. This suggests that the country's markedly pro-FDI policies and the fact that those policies have remained stable since 1974 have done more than tariff reduction has to stimulate export growth.

Two aspects that must be taken into consideration when evaluating Chile's two trade reform programmes are their impacts on capital formation and the growth of the manufacturing sector. Although gross fixed capital formation and capital efficiency had increased since the end of the recession of the early 1980s, the coefficient for fixed investment was

<sup>5</sup> Most capital goods imports were eligible for a wide range of exemptions.

TABLE 3

**Chile: selected growth indicators, 1961-1992<sup>a</sup>**  
(Percentages)

	1961-1971	1971-1974	1974-1981	1981-1989	1989-1992
GDP growth rate	4.7	0.3	2.6	2.3	6.0
Growth rates for real exports: <sup>b</sup>					
Total exports	3.4	9.1	7.1	8.5	10.9
Non-copper exports	4.7	8.5	12.8	11.5	13.4
	1961-1970	1971-1973	1974-1981	1982-1989	1990-1992
Gross fixed investment / GDP	20.2	15.9	15.7	15.2	19.1
Manufactures / GDP	25.4	27.2	22.0	20.5	20.6
Exports <sup>c</sup> / GDP	12.0	9.9	20.2	27.0	32.4

Source: Calculations by the authors based on figures from the Central Bank of Chile and from Ffrench-Davis and Muñoz, 1990, tables 1, 3 and 6.

<sup>a</sup> At 1977 prices.

<sup>b</sup> Exports of goods.

<sup>c</sup> Exports of goods and services.

still below 20% of GDP at the start of the 1990s, a mark attained as far back as the 1960s. The economy's inability to surpass that level of investment prevented it from achieving significant growth in the period between 1974 and the end of the 1980s; indeed, the average cumulative growth rate for that period was only 2.3% per year.

During the first liberalization programme, the economy was subject to a rapid de-industrialization process, as evidenced by a five-point drop in the manufacturing sector's share of GDP. Many potentially strong manufacturing enterprises went bankrupt as a consequence of the particular combination of trade and exchange policies in use during that period.

The success of the second liberalization effort notwithstanding, the de-industrialization process set in motion by the first programme has not been reversed, and exports are still concentrated in natural resource-intensive product lines. It is also true, however, that the relative share of products with more value added has been expanding, investment has continued to rise, and the creation of new production capacity (although only since the start of the 1990s) has begun to increase at a sustainable pace which is also faster than the rate recorded for the 1960s.

### 3. Mexico

Like Chile, Mexico, too, launched a programme in mid-1985 that called for a drastic form of import liberalization and a gradual disassembly of the country's traditional instruments of industrial policy.

It is important to note that, in contrast to the Chilean experiment of the 1970s, Mexico's liberalization effort was preceded and followed by a steep real depreciation of the currency (in 1982-1983 and in 1986-1987) which gave the manufacturing sector a large foreign-exchange "cushion" for its adjustment (Ten Kate, 1992). These large devaluations were necessary in order to cope with the balance-of-payments and fiscal crises sparked by the suspension of external credit (in 1982) and the drop in oil prices (in 1986-1987).<sup>6</sup>

Before embarking upon its trade liberalization programme, Mexico had used a wide variety of instruments to control imports, stimulate industrial production and steer the manufacturing sector towards external markets. In addition to a widely dispersed tariff structure having a ceiling rate of 100%, Mexican producers were protected by a system of advance permits applying to 92% of all imports and by the use of official prices for purposes of customs valuations which, in 19% of the cases, were higher than the imports' purchase prices. Exporters of non-traditional products were given large tax breaks to offset the anti-export bias of the country's trade policy. Furthermore, for quite some time Mexico had successfully been using industrial promotion programmes oriented towards import substitution in "strategic sectors" (in

<sup>6</sup> In Mexico, as in Chile, these devaluations helped the country to balance its fiscal accounts, since the earnings from its main export product are a major source of tax revenue and have converted the public sector into a net supplier of foreign exchange.

some cases in conjunction with export promotion measures). These programmes, which provided firms with protection in the domestic market and with tax incentives in exchange for the achievement of increasingly higher levels of local integration or export targets, had become the country's main industrial policy tool during the "difficult stage" of the import substitution process (Ros, 1992).

(i) *The reform programme launched in 1985.* The trade liberalization programme began in July 1985 with the elimination of quantitative controls on a large number of tariff positions. Its measures primarily affected intermediate and capital goods, but also applied to some consumer goods. Tariff rates were high in the beginning to offset the elimination of direct controls. Then, in July 1986, Mexico joined GATT, and its "entry fee" was a commitment to continue to substitute tariffs for direct controls and, later on, to reduce tariff rates. At the same time, a system of anti-dumping mechanisms was set up. In late 1987, together with the introduction of what was called the Economic Solidarity Pact, trade reforms were intensified: a large part of the advance permit requirements pertaining to consumer goods were discontinued; the remaining official prices were eliminated; and the tariff structure was simplified to the point where it involved only five rates, ranging from 0% to 20%, with a production-weighted average of 12% (and an import-weighted average of 6%). Subsequent adjustments made to narrow the spread of tariff rates even further had the effect of raising this average somewhat, but did not significantly change the liberal focus of Mexico's trade policy.

Mexico's trade reform programme has encompassed exports as well, and many export permit requirements have been eliminated. Those quantitative export restrictions that are still in effect are made necessary by the existence of price controls (on some agricultural products) or by bilateral or international agreements (regarding coffee, sugar, steel and textiles, which together still represent 24% of the country's non-oil exports, including the value added by the maquila, or inbond assembly, industry). The traditional sorts of export subsidies have been eliminated, in part as a consequence of bilateral agreements with the United States. The only export incentives now in use are programmes allowing duty-free entry for "temporary" imports and exemptions from import permit requirements for inputs brought in by export firms.

The use of industrial promotion policies has also been reduced substantially. The programmes that remain, which continue to place quantitative

restrictions on imports, primarily apply to the automobile, microcomputer and pharmaceuticals industries.

The thick exchange cushion created by the real devaluations of 1986 and 1987 enabled the Government to launch its Economic Solidarity Pact, which included a freeze on the exchange rate, more extensive trade liberalization measures and wage restraint. In effect, the exchange rate began to be used as a tool for controlling inflation. During 1988 the nominal exchange rate was frozen and since 1989, nominal devaluations have been less than the net rate of inflation (the domestic rate minus the external rate). Since 1987, the real effective exchange rate has reflected a steady appreciation of the currency (see table 4).

The Economic Solidarity Pact was highly successful in cutting inflation back sharply. Along with the privatization of the banking system and the decision to participate in the Brady Plan, it helped to change expectations regarding the future of the Mexican economy. This change, in turn, helped to bring in a large volume of foreign capital and repatriations of flight capital that had left the country at the time of the external debt crisis. This inflow of foreign capital has made it possible to sustain a real revaluation of the Mexican peso and has helped to quicken the pace of the revaluation process. Foreign capital inflows have also been stimulated by reforms in other areas of economic policy, such as domestic deregulation, the privatization of a large number of government-owned enterprises, opening up the economy to foreign investment, and authorization for foreign mutual funds to invest in the stock market. In order to moderate these capital inflows, in April 1991 some controls on the banks' acceptance of foreign-currency deposits were reinstated: a certain percentage of such funds cannot be loaned out in pesos but must instead be held as liquid foreign-exchange assets, and foreign-currency deposits may not exceed 10% of total deposits.

(ii) *Gross domestic product and export performance.* Mexico's exports of manufactures have achieved high growth rates and the manufacturing sector's share of GDP has expanded slightly, but the Mexican economy's overall post-reform growth rates have been quite modest (see table 5). Between 1985 and 1992, per capita GDP did not increase at all and, although investment has made a substantial recovery, it is still below historical levels (investment coefficients have ranged from 16% to 22% of GDP, as compared to levels of between 22% and 25% in the 1970s).

TABLE 4

**Mexico: trade policy indicators and real exchange rate, 1981-1992**  
(Percentages)

Year	Domestic production protected by import permits <sup>a,b</sup>	Domestic production protected by official prices <sup>a,b</sup>	Average tariff <sup>a,b</sup>	Number of tariff lines	Maximum tariff	Real exchange rate <sup>c</sup>
						(1985=100)
1981	64.0	13.4	22.8	...	...	72
1983	...	...	...	...	...	115
1984	92.2	18.7	23.5	...	...	100
1985	47.1	25.4	28.5	10	100	100
1986	39.8	18.7	24.5	11	50	139
1987	25.4	0.6	11.8	11	40	145
1988	21.3	-	10.2	5	20	118
1989	19.8	-	12.5	3	20	110
1990	17.9	-	12.4	3	20	108
1991	...	-	12.0	3	20	98
1992	...	-	12.0	3	20	91

Source: Ten Kate (1992), Ros (1992) and ECLAC (1992a and 1992b).

<sup>a</sup> The figures shown for 1985 through 1990 refer to December of each year; the figures for 1981 correspond to April 1980 and those given for 1984 correspond to June 1985.

<sup>b</sup> Weighted by output.

<sup>c</sup> Exchange rate applying to exports (ECLAC, 1992a).

TABLE 5

**Mexico: selected growth indicators, 1980-1992**

Year	GDP growth rate (percentages)	Fixed investment / GDP (percentages)	Manufactures / GDP (percentages)	Non-petroleum exports		
				Billions of dollars		As a percentage of total exports <sup>a</sup>
				Goods	Maquila services	
1970-1979	6.5	23.4 <sup>b</sup>	22.8	...	...	85.9
1980	9.2	24.8	22.1	6.0	0.8	40.0
1985	2.6	17.9	21.4	6.9	1.3	35.6
1986	-3.8	16.4	21.0	9.7	1.3	63.6
1987	1.9	16.1	21.3	12.0	1.6	61.8
1988	1.2	16.8	21.7	14.1	2.3	71.3
1989	3.3	17.4	22.5	15.0	3.1	69.9
1990	4.4	18.8	22.8	16.9	3.6	67.4
1991	3.6	19.5	22.9	18.9	...	...
1992	2.5	21.7	22.7	19.5	...	...

Source: ECLAC (1992b and 1993) and Ros (1992).

<sup>a</sup> Share of total merchandise exports plus maquila services accounted for by non-oil merchandise exports plus maquila services.

<sup>b</sup> Simple average for the period 1970-1979 in constant 1980 dollars.

The Mexican economy has, however, undergone a major structural change in the form of a sustained increase in exports other than petroleum, which climbed from US\$4.8 billion in 1982 to US\$9.7 billion in 1986 and to US\$18.9 billion in 1991. By the end of the 1980s, manufactures accounted for 85% of total non-petroleum exports.

Champions of the trade liberalization initiative contend that import liberalization is what has made the boom in non-oil exports possible by giving producers of exportable goods access to high-quality inputs at international prices and by making it less profitable to produce for the domestic market (thereby indirectly encouraging an export-oriented

reallocation of resources). However, the sharp increase in non-oil exports had begun in 1983, before the introduction of trade reforms, and it is therefore difficult to attribute the expansion entirely to those reforms. Ros (1992) has estimated that nearly one half of the increase in exports other than petroleum during the period 1982-1988 was accounted for by three sectors (the automobile, computer and *maquila* industries)<sup>7</sup> which did not benefit from the measures adopted in order to open up the economy, either because their imports of inputs were already duty-free (the *maquiladoras*) or because the imports that were competitive with their products or their imported inputs remained subject to restrictions under industrial development programmes (automobiles and personal computers).

One hypothesis which fits in better with actual trends in the Mexican economy is that the non-petroleum export boom had more to do with the steep real depreciation of the currency seen in 1982-1983 and 1986-1987 and with the depression that hit domestic markets, which obliged producers to look for markets outside the country, especially in the United States. Most of Mexico's new exports of manufactures are produced by industries that were founded during the era of import substitution with a relatively small new investment; there has not been any large-scale reallocation of resources to sectors in which Mexico may be supposed to have comparative advantages (labour-intensive activities oriented primarily towards external markets). Hence, Mexico's successful bid to expand its exports has largely been made possible by its earlier import substitution effort and the development programmes implemented in strategic sectors (Ros, 1992).

#### 4. Bolivia

As part of its effort to stabilize and organize its economy in order to overcome hyperinflation and resume its growth, during the final quarter of 1985 Bolivia initiated an ambitious trade liberalization programme which it has been applying ever since (Morales, 1992). Before the start of its programme, Bolivia had a highly dispersed tariff structure with a maximum rate of 150%; it also had banned some imports and required import permits for others. Its first steps were

to establish a single exchange rate, restore complete convertibility, dismantle its quantitative restrictions and reduce tariff levels. In addition, the capital account was opened up almost entirely. Since then, major devaluations have been instituted, as evidenced by the movement in the Bolivian currency's real effective exchange rate (see table 1).<sup>8</sup>

In July 1986 Bolivia greatly simplified its tariff structure by establishing a uniform 20% tariff rate. Early in 1988, the tariff on capital goods was lowered to 10%, with the 20% rate being retained for other products until the end of that year, when it was reduced to 17%. In 1990, tariffs were lowered to 5% on capital goods and 10% for other products and have remained at those levels since then. Thus, the Bolivian economy has become one of the most open economies in Latin America and, indeed, the world.

In order to stimulate non-traditional exports, a subsidy equivalent to 10% of the value of exported products was instituted. This instrument, which was known as the Tariff Drawback Certificate (CRA), was intended to mitigate the anti-export bias generated by the duties levied on imported inputs that were used in producing items for export. For fiscal reasons and by agreement with the International Monetary Fund (IMF) and the World Bank, the CRA was discontinued in early 1991.

As may be seen in table 6, ever since Bolivia put an end to hyperinflation in 1986, its economy's growth rates have been quite modest, especially in comparison to those recorded in the 1970s. In the six years following the steep decreases registered in 1985 and 1986, per capita GDP has risen by less than 1% annually. What little economic growth has been achieved has not even been enough to bring per capita GDP up to 80% of what it was before the crisis of the early 1980s. In addition, investment, when measured as a percentage of GDP, fell following the reforms. The decline in private gross fixed investment from 7% of GDP in 1982 to less than 4% in 1990 is particularly worrisome (Morales, 1992), although it was up somewhat again in 1991-1992. One positive development, in addition to the sharp reduction made in inflation, has been the diversification of exports, although they are still concentrated in the categories of mineral or agricultural products. Non-traditional exports rose steeply between 1988

<sup>7</sup> Only the value added by the *maquila* sector is computed as an export in Mexico's statistics. In keeping with Ros (1992), here the *maquila* sector is reclassified under merchandise exports.

<sup>8</sup> The system used by Bolivia for determining its currency's exchange rate can be characterized as a dirty float.

and 1990, but then slipped a bit in 1991 and 1992; meanwhile, it took total exports until 1990 to regain a level close to that of 1980, and then they, too, declined during the following biennium. Thus, the Bolivian experiment demonstrates that in a largely

undiversified economy with low levels of productivity, reforms aimed at altering market signals in order to align domestic prices with international prices are clearly not enough to initiate or carry forward a timely process of structural change.

TABLE 6

**Bolivia: selected growth indicators, 1970-1992**  
(Percentages)

Year	GDP growth rate	Gross fixed investment/GDP	Real export growth rates	Total exports (millions of dollars)	Non-traditional exports <sup>a</sup> (millions of dollars)
1970-1980	3.9		-10.5		
1980-1984	-1.9	12.1	-28.3	871 <sup>b</sup>	68
1985	-1.0	12.3	-7.6	673	35
1986	-2.5	13.3	4.5	638	108
1987	2.6	13.6	-0.2	569	106
1988	3.0	13.6	3.7	600	108
1989	2.8	12.7	18.5	822	204
1990	2.6	12.1	20.8	927	292
1991	4.1	12.9	2.3	849	252
1992	3.4	13.3	-11.1	710	205

Source: ECLAC (1992b) and ECLAC (1993).

<sup>a</sup> Total exports except zinc, tin, silver, tungsten, antimony, gold, lead, other minerals, natural gas and other hydrocarbons.

<sup>b</sup> Simple average.

### III

#### The lessons to be learned from Asia's dynamic economies

Despite their great diversity, the manufactures-exporting economies of Asia have some characteristics in common with regard to their development strategies and policies (and their results) which make a comparison between them and Latin America particularly instructive. The analysis to be undertaken in this section will be based on the experiences of the Republic of Korea and the Chinese province of Taiwan, which have been engaged in an outward-looking industrialization process for several decades now. Since the late 1970s, other Asian economies (Indonesia, Malaysia and Thailand) have been implementing fairly similar policies and they, too, have had positive results in terms of promoting growth based on exports of manufactures (Agosin, 1992; Noland, 1990; Ariff

and Hill, 1989). In all of these economies, the industrialization process started out with an import-substitution model and, without exception, subsequent policies aimed at giving the economy an outward-looking orientation have been superimposed upon the existing import-substitution system (Noland, 1990, chapters 2 and 3). These economies made the transition to an outward-oriented industrialization model without going through any contortions because it was based, in large part, on the industrial skills and capacities they had developed earlier.

In general, the strategy they used was to provide relatively equal incentives for exports and for production intended for the domestic market *within any given industry* but to offer quite dissimilar incentives

(and ones that changed over time) to *different industries*. In formal terms, the effective exchange rate, which incorporates the effects of all the various incentives (tariffs, subsidies, etc.), for exports was more or less equal to the effective exchange rate for import-substitution activities in industry *i*, but differed substantially between industry *i* and industry *j*:

$$TCE(X_i) \approx TCE(M_i);$$

$$TCE_i \neq TCE_j$$

Although the level of protection in the Republic of Korea and the Chinese province of Taiwan has decreased considerably in the past few decades and is now approaching levels characteristic of developed countries (Noland, 1990), these economies began their outward-oriented industrialization processes with high protective barriers which were not dismantled for the sake of reorienting the economy towards exports.<sup>9</sup> One facet of this process which an observer of the rapidly-growing economies of Asia cannot help but notice is the State's ability to provide incentives and then to take them away again, thereby preventing them from becoming vested interests of the businesses which have received them. In other words, the State has demonstrated a striking ability to apply *temporary promotion policies*. Furthermore, all such incentives have traditionally been granted only in exchange for the achievement of specific targets, usually in the area of exports.

Another highly significant aspect of these experiences is the authorities' success in forestalling a major revaluation or preventing the real exchange rate from exhibiting sharp fluctuations such as those usually seen in the Latin American countries. The presence of tariffs and other substantial trade barriers obviously indicates that the currencies of these Asian economies were overvalued, but the degree of overvaluation was moderate and was in most cases offset by various sorts of export subsidies. In order to control their exchange rate, most of these economies have exercised effective control over foreign capital flows and have achieved a satisfactory degree of macroeconomic stability.

<sup>9</sup> For example, in 1976, more than a decade after its industrialization process was launched, the Republic of Korea had tariffs ranging from 0% to 150%, and for nearly 1,000 tariff items (approximately 40% of all items), the rates were between 30% and 60%. Quasi-tariff mechanisms and exemptions were also used heavily (Ffrench-Davis, 1986).

The Asian countries' experiences suggest that trade liberalization is not a necessary element of export-based industrialization. In fact, most of these economies have been able to maintain relatively protectionist policies and to grow outward at the same time. Two factors play a fundamental part in accounting for this phenomenon, which appears to fly in the face of conventional trade policy recommendations. The first of these factors is that, in all the successful cases, the authorities have made heavy use of various sorts of export subsidies to offset the anti-export bias implicit in the protection of importable product lines; each and every one of the Asian economies examined here have mechanisms for refunding tariffs and indirect taxes to exporters and some have more than one such mechanism, with exporters being able to choose among them according to their particular circumstances. The second factor is that incentives have been provided in exchange for the achievement of specific performance targets and for limited periods of time.

Although all of Asia's fast-growing economies have certain characteristics in common, there are also some significant differences among them which are of interest to us here, since Latin America has important lessons to learn from each of these countries' experiences. Perhaps the most interesting aspect of the Republic of Korea's experience has been the different ways in which mature and infant industries have been treated (Westphal, 1992). The trade policy applied to mature industries was intended to be neutral, so drawback mechanisms were designed to refund customs duties and indirect taxes to both direct and indirect exporters (the latter being producers that sell inputs to exporters). During the 1960s, these businesses also enjoyed additional incentives, such as access to credit on easy terms, preferential access to import permits, and some reductions in direct taxes.<sup>10</sup>

The provision of incentives (which were tied to export targets) for government-promoted infant industries was much more aggressive. The main method used for this purpose was the award of temporary monopolies to selected firms in the branches of industry which the Government wished to promote in exchange for the achievement of specific export targets. This meant that, in practice, the promotion of import substitution was transformed into an export-promotion mechanism. These firms soon became

<sup>10</sup> Incentives other than drawback mechanisms started to disappear in the 1970s, but the levels of protection provided for these sectors on the domestic market were also lowered.

exporters, since they were able to subsidize their external sales with the substantial profits they realized in the domestic market. Perhaps the crucial factor in arriving at this result was that the system of incentives in use prompted these firms *to attain international competitiveness from the very outset*. This emphasis enabled them to rapidly take advantage of economies of scale and to learn through hands-on experience.

Another important element was the preferential access to *short- and long-term* credit on easy terms which was provided to firms in the selected sectors. Actually, by favouring certain sectors, the Government was favouring specific conglomerates whose creation it had instigated. This stimulus for the emergence of agents of production in State-promoted sectors, in conjunction with ample access to credit at subsidized interest rates for these activities, was the State's (successful) way of making up for the capital markets' shortcomings (Amsden, 1993). The industrial policy was a sequential one: in the 1960s priority was placed on investment in cement, fertilizers and oil refineries; in the late 1960s and early 1970s, the emphasis was on steel and petrochemicals; in the 1970s, importance was placed on shipyards, capital goods and consumer durables (including motor vehicles); and in the 1980s, the focus was on electronics, telecommunications and informatics.

The industrial and trade policies applied in the Taiwanese economy have in some ways been similar, particularly as regards the sequencing of State support for specific firms and sectors: special assistance was given to the textiles, glass, plastics, cement and

consumer electronics industries in the 1950s; to synthetic textiles and steel in the 1960s; to motor vehicles in the 1970s; and to the information industry since the late 1970s (Wade, 1990a and 1990b, chapter 4). As in the Republic of Korea, State leadership in respect of the industrial strategy focused on high-overhead, capital-intensive activities or on activities in which the technology was monopolized by a small number of potential suppliers. These were industries which were expected to become internationally competitive.

Some of the promotion mechanisms were similar to those used in the Republic of Korea, including the protection of the domestic market, subsidized long-term credit, and tax exemptions. One somewhat different facet of the Taiwanese experiment, however, was the aggressive use of State enterprises and investment and the promotion of foreign investment (usually in partnership with national capital) in the sectors selected for promotion.

As time has passed, the State's leadership role in implementing this industrial strategy has been tempered and has taken on a less interventionist cast both in the Chinese province of Taiwan and in the Republic of Korea. It is hoped that, as a result of the trade reforms now being undertaken, both economies' tariff levels and spreads will closely approach those of industrialized countries (Noland, 1990, pp. 9-11). As the State withdraws from its leadership role in industry, protection is gradually taking on the same function in these economies that it performs in industrialized countries, i.e., that of defending the most backward sectors (especially agriculture).

## IV

### Criteria for an evaluation

An examination of Latin American liberalization efforts and of the longer-term Asian programmes yields conclusions that may have an important bearing on economic policy management in Latin America. These findings can help to adjust reforms now under way so that they will contribute more efficiently to the countries' efforts to speed up their growth and to change their production patterns. This does not mean that countries which have embarked upon comprehensive reforms should retrace their steps. The reversal of policies that are already in place can have such

a high cost that it may be better to continue with existing policies even if they are suboptimal. What must be done even in such cases, however, is to assess both the steps already taken and their existing or probable outcomes in order to determine what else needs to be done to increase the probability that the countries of the region will reach the goals which their trade liberalization efforts are intended to achieve, i.e., the establishment of a position within the international economy that will be more effective in furthering their development.

## 1. The relationship between import liberalization and export promotion

Experience has demonstrated that it is more effective to liberalize imports once a sustained increase in exports and a dynamic transformation of the production apparatus have already been achieved. The cases of the East Asian countries bear witness to this fact (Sachs, 1987). This is the first of the options set forth in the analytical scheme presented earlier (see section II, subsection 1 and figure 1). Although this course of action is no longer a feasible option for many Latin American countries, the Asian countries' experiences demonstrate the need to take direct steps to boost exports rather than waiting for import liberalization alone to have the desired effect on export performance.

In the majority of the liberalization programmes being pursued in Latin America (especially in the cases of Argentina, Colombia, Peru and Venezuela), the option of promoting exports first and liberalizing imports later has already been explicitly ruled out; a liberalization programme has already been carried out, and it was done in a context where the creation of production capacity in these countries' economies was a far cry from being dynamic. A similar path was chosen by Chile, Bolivia and Mexico, which liberalized their imports without providing any significant measure of support for exports other than a depreciation of the currency (and even this trend tended to reverse itself in Chile during the period 1979-1982 and in Mexico starting in 1988). Moreover, all the countries that have undertaken sweeping reforms have proceeded to dismantle or cut back export promotion schemes that had been successful in the past. This suggests that the costs of these liberalization programmes in terms of growth will be high while the transition is being made to a new equilibrium. One constructive question that might be posed at this point is, given the constraints imposed by the path already chosen, how can the overall efficiency of the reforms be enhanced? The suggestions that follow are all directed towards achieving that objective.

## 2. Incentives: selectivity versus neutrality

Neither the mainstream of past experience or the cases discussed here support the hypothesis that, once a country has made its incentives neutral by dismantling all protection and discontinuing all subsidies, resources will be reallocated spontaneously

and inexpensively to the sectors in which that country has comparative advantages. Chile's experience attests to the high costs of a radical liberalization drive which did away with all traces of selectivity. It is unlikely that these costs (in essence, the costs of the transition) will be cancelled out by the more rapid growth that may be achieved after the adjustment has been completed. As is suggested by the Asian countries' experiences, more selective, less drastic policies regarding the liberalization of imports, together with firmer support for non-traditional exports, might well have enabled the economy to turn in a stronger overall performance.

If the aim is to change production patterns efficiently in a way that will make the economy more open to external trade and carve out a qualitatively different position for it within international markets, then the entirely passive momentum generated by liberalization will not suffice; policies that create an active form of momentum will also be needed. Obviously, this does not mean that we should return to the high, indiscriminate protective barriers of the past. In fact, it can be argued that import substitution policies erred by being too indiscriminate rather than too selective. What is needed is a much greater degree of selectivity, not in the sense of giving support to specific activities (which may be difficult to identify), but rather of making sure that deviations from neutrality are few and well chosen.

The desired form of selectivity must also stay clear of the anti-export bias of the past; in other words, equivalent incentives should be given for exports and for production for the domestic market. Under present circumstances, and given the small size of most of the region's economies, an argument can be made for explicitly pro-export policies. Since the Latin American countries have opted for above-zero tariff levels and, in all cases except that of Chile, for some degree of differentiation, then roughly equivalent export subsidies are required.

There are no compelling theoretical or practical reasons for choosing absolute uniformity in the case of tariffs. If most industrial activities are subject to dynamic economies of scale of a more or less diffuse nature, then it can be argued (as it is by Rodrik, 1992) that it is best to benefit broad categories of manufacturing activities rather than getting embroiled in trying to "pick winners" by favouring specific industries. Moderation in terms of the number of tariff levels and brackets will help to curb abuses. Furthermore, any tariff in excess of the base level should be temporary in nature.

As noted earlier, export subsidies are necessary, especially if the aim is to promote an efficient form of industrialization in the presence of import duties. One element that is essential in order to avert an anti-export bias is the establishment of drawbacks on inputs used in the production of exportable goods. Indeed, cases can be found both in Latin America (e.g., Colombia, Costa Rica and Brazil) and in Asia where subsidies for non-traditional exports have been in place for extended periods of time and have yielded positive results. In order to minimize the possibility that such subsidies may be misused, consideration might be given to designing a system whereby subsidies would decrease as exports increase based on a pre-established, publicly-announced timetable that is not subject to renegotiation.

Selectivity involves a number of different aspects which extend beyond the bounds of trade policy and cannot be examined in detail here. These elements include means of giving exporters access to pre- and post-shipment commercial credit at international interest rates, measures to supplement the capital market and eliminate its bias against new projects, the improvement of the physical and social infrastructure needed to carry forward the development of the export sector, policies on foreign direct investment that will facilitate the acquisition of new technologies and access to international markets, and the adoption of a coherent policy regarding involvement in international trade negotiations for the purpose of gaining access to the international markets in which a given country hopes to position itself.

To return to the subject of incentives for a moment, one fact which policy-makers should bear in mind as they proceed to formulate trade policies for the 1990s is that the international situation has changed substantially since the burgeoning economies of East Asia embarked upon their export-based industrialization processes in the 1960s and 1970s. Today, it would be much more difficult to offer incentives of the magnitude that were granted at that time by the East Asian economies, both because of the more sluggish and more protectionist environment that now exists in the international economy (which now makes it more likely, for example, that importing countries would protect themselves against export subsidies by levying countervailing duties) and because international rules and standards

in the area of trade policy are much stricter than they used to be. Moreover, if the Uruguay Round is brought to a successful conclusion, it is highly probable that the developing countries' manoeuvring room for the subsidization of exports will be even further reduced.

### 3. Gradual or swift liberalization?

The Latin American countries that have undertaken trade liberalization programmes in recent years have clearly opted for a rapid form of implementation. The comments made in this section are therefore directed primarily to countries that have not yet consolidated their reform process. It is still too early to evaluate the results of these recent, drastic reform efforts. Be that as it may, the experiences of the Asian economies as well as of Colombia between the mid-1960s and 1989 (Ocampo and Villar, 1992) and of Costa Rica between 1983 and 1990 (Herrera, 1992) appear to suggest the advisability of a gradual approach that permits the retrofitting of existing industries rather than destroying a large percentage of a country's installed capacity, as inevitably occurs during a rapidly-applied liberalization initiative.

In Colombia, the transition made in the mid-1960s from an import-substitution model to a mixed model that placed priority on both import substitution and export promotion has played a pivotal role in steering the manufacturing sector towards an increasingly external orientation while avoiding the trauma associated with drastic liberalization drives such as Chile's. In Costa Rica, tariff reduction was a gradual process and was coupled with export incentives and drawback mechanisms. The expansion of non-traditional exports—the most salient feature of Costa Rican development in the 1980s—was in large part generated by firms established during the application of the earlier import-substitution model. In addition, a deliberate effort was made to promote foreign investment in the production of exportable textiles and electronics.

The adoption of a gradual approach does not mean that all reforms need be gradual, however. The elimination of the slack in tariffs, the conversion of quantitative restrictions into tariffs ("tariffization") and the necessary exchange-rate adjustments can all be done at a single blow. Subsequent tariff reductions should, however, be phased in gradually so as to keep pace with producers' ability to adapt their production structures to increased competition.

#### 4. The role of the exchange rate

The way in which the exchange rate is handled will undoubtedly play a decisive role in determining the outcome. Averting an exchange-rate lag would seem to be essential to the success of any trade reform whatsoever, regardless of whether it takes the form of a drastic liberalization drive or a gradual, controlled opening of the economy. Once again, the Chilean experiment of 1976-1981 (as well as the experiences of other Southern Cone countries during the 1970s) show just how harmful the combined impact of a real appreciation of the currency and a drastic import liberalization programme can be. In contrast, the new adjustment undertaken by Chile between 1983 and 1991 was more successful and sustainable than the programme it implemented in the 1970s because tariff reduction was coupled with a steep real devaluation.

Most of the more recent liberalization programmes in Latin America are being implemented in the presence of a sharp appreciation of the currency in real terms. In fact, some of the countries in which the import liberalization process has been the most comprehensive have also experienced severe exchange-rate lags. The question of how the exchange rate should be managed in order to bolster the process of changing the production apparatus is an aspect of economic policy that has not yet been satisfactorily addressed in Latin America.

The experiences of the Latin American countries demonstrate that exchange policy alone is not an adequate substitute for an effective anti-inflation policy. Except in the short term when it is used as a means of changing expectations, the exchange anchor for domestic prices has proven to be extremely flimsy, particularly in high-inflation countries. Stabilizing price levels is certainly an essential step in any policy attempt to bring about a permanent change in relative prices, but this cannot be achieved simply by fixing the nominal exchange rate. The exchange rate is an indispensable tool for changing production patterns while maintaining an external equilibrium. This is one of the messages of the East Asian success stories.

#### 5. External financial liberalization

Another lesson to be learned from an examination of the differences between the Latin American and Asian experiences is that the liberalization of international capital flows can jeopardize the achievement

of trade liberalization objectives.<sup>11</sup> Financial liberalization has two components –one internal and the other external– that usually go together. Internal financial liberalization involves, *inter alia*, allowing interest rates to be determined by market forces. External financial liberalization takes the form of a combination of various measures: permitting non-residents to deal in the domestic financial market or permitting residents to take out loans in international financial markets; permitting residents to buy foreign exchange in the domestic market and then to invest or spend it abroad; and permitting foreign-currency transactions to be conducted in domestic markets. While internal financial liberalization strengthens the link between inflation and interest rates, external financial liberalization weakens the link between domestic prices and the exchange rate (Akyüz, 1993). This makes it more difficult to implement a trade liberalization programme successfully, for two reasons. First, the combination of internal and external financial liberalization measures makes the exchange rate difficult to control. Second, it raises interest rates and makes them more volatile, thereby discouraging productive forms of investment.

The simultaneous liberalization of internal and external financial dealings poses serious problems for economic policy management. Internal liberalization measures usually lead to steep increases in interest rates (both nominal and real) and to wide swings in those rates over a protracted period of time; when a gap opens up between domestic and international interest rates and it does not appear that the gap is going to be closed by a depreciation of the currency, then destabilizing capital flows can reach considerable proportions.

Under conditions such as those prevailing during the second half of the 1970s or the early 1990s, external financial liberalization makes the management of the real exchange rate more difficult (Williamson, 1992). Short-term capital flows generated by the hope of turning a speculative profit from the differential between international and domestic interest rates may cause the real exchange rate to become highly unstable and may thus hinder the management of this variable, which is an economic policy tool of crucial importance in any attempt to change production patterns.

<sup>11</sup> Regarding the sequencing of trade and capital-account liberalization measures, see Edwards, 1989. On stability and capital movements, see Díaz-Alejandro (1985) and Williamson (1992).

Moreover, instability in exchange and interest rates tends to stimulate an attitude in which profit-seeking predominates over considerations of production and to send out mixed signals to resource allocators.

Some recent examples can be found in the region of fairly successful approaches to the management of speculative capital. One such example is that of Chile, which learned from its experiences in this connection. The steep appreciation of Chile's currency seen in the late 1970s was attributable to the fact that national banks had unrestricted access to external credit. More recently, the adoption of a more pragmatic attitude has made partial protection of the exchange rate possible and has helped make the benefits of trade liberalization more tangible. Colombia has also availed itself of a variety of measures to staunch the short-term capital flows that threatened to trigger a revaluation. Brazil and Mexico have also made some attempts to moderate short-term financial flows.

In a number of other Latin American countries, recent trade liberalization efforts have been accompa-

nied by fairly ambitious financial liberalization initiatives coupled with heavy inflows of capital that have tended to outstrip the monetary authorities' ability to sterilize those flows. In these countries, the move to dismantle controls on capital and the authorities' inability to regulate capital movements are hindering efforts to open up production activities to foreign trade.

Hence, as regards the balance-of-payment capital account, the problem being faced by the countries of the region is how to link national capital markets up with external capital markets in a way that will minimize artificial inefficiencies (currency appreciations that tend to move the markets away from equilibrium) and the destabilizing effects of short-term capital flows, which usually appear when they are not needed and tend to dry up when they are essential to balance-of-payments equilibrium. It therefore appears necessary to distinguish between flows of foreign capital having long-term production objectives (e.g., foreign direct investment), which are beneficial, and other short-term flows of a purely speculative nature, which need to be discouraged.

## V

### Final considerations

In conclusion, past experience seems to demonstrate that, together with a rationalization of trade incentives, some degree of selectivity must be exercised with respect to a country's policy for the development of production. This is what has been done in the fastest-growing economies of East Asia. The problem lies in how to identify the most efficient mechanisms, which will include gradually decreasing incentives tied to specific export targets, and the necessary reforms in the public sector's institutional structure. The degree of selectivity must actually be greater than during the import substitution phase, and the criteria on which its administration is based need to be clearly defined. Protection for national production activities and export incentives are part of a policy package aimed at implementing a development strategy and changing production patterns. But experience teaches us that incentives must be moderate and have definite time limits; that departures from neutrality must be few and well chosen; and that the anti-export bias of protection must be

counterbalanced with export incentives. It also seems to be more efficient to provide incentives for broad categories of activity—those which have the greatest chance of providing dynamic benefits that will not be internalized by the market—than to try to “pick winners”. The promotion of non-traditional exports appears to be a particularly appropriate sphere for selective trade policies.

Other aspects of selectivity mentioned in this article which have not been accorded due attention in recent reform efforts (or, for that matter, in some longer-standing ones, such as Chile's) have to do with what the State does to correct market flaws that hamper investment oriented towards changing production patterns. Such State action includes policies for supplementing the capital market, attracting foreign investment to new sectors that can acquire comparative advantages and upgrading physical and social infrastructure, along with the application of an effective vocational training programme and the negotiation of access for specific products to specific markets.

In order to open up the production sector in a way that will further a country's development, corrections will have to be made in the extreme forms of liberalization advocated in recent years. More realistic adjustments will certainly have to be made in the policies being applied by many countries.

Trade policy modifications should be accompanied by a greater appreciation of the exchange rate's role in bringing about changes in production patterns. It appears to be impossible to steer the private sector's production activities firmly in the direction of internationally tradable goods unless a favourable exchange rate that remains stable over time (i.e., that

withstands the influence of temporary economic conditions) is maintained. The economic authorities of the region need to devote greater attention to the economic policies required to achieve this objective, one of which will surely be the regulation of short-term international capital flows.

One essential condition for a successful liberalization effort is a supportive international environment. Unless protectionism is eradicated from the central countries, liberalization will be greatly weakened as a policy option—not, as in East Asia in the 1960s, for just a few countries but for the wide range of countries that are currently pursuing liberalization initiatives.

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# Growth, crises and *strategic turnarounds*

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The import-substitution strategy was entirely justified in the 1930s and continued to make sense until the late 1950s, so long as export opportunities were being dampened by the Great Depression, the Second World War and the reconstruction of Europe. From the 1960s on, however, it afforded diminishing returns as international trade burgeoned. During the 1980s, the macroeconomic instability caused by the debt crisis compounded the problems associated with this development strategy, which had begun to become apparent in the 1970s. Evidence to this effect was provided by the region's declining productivity and increasing vulnerability to external shocks. This is why today's infant industries are concentrating their attention on gaining a foothold in external markets rather than on the acquisition of production skills. Despite the consensus that is taking shape with respect to this outward-looking orientation, significant differences still remain between the neostructural and neoliberal visions of society in respect of both their development focus and instruments. The role of the State: How active or passive should it be? The bias of export incentives: Should they be temporarily pro-export, or neutral? Social equity: Should we see distribution as just a question of time (the trickle-down strategy), take a parallel approach whereby economic policy is devoted to growth and social policy to distribution, or, as the author suggests, apply an integrated approach in which economic policy would incorporate objectives of both distribution and social equity? The article closes with a counterpoint between the orthodox focus, which concentrates entirely on liberalization and deregulation, and the neostructuralist approach, which advocates the use of more active instruments by a more effective public sector to eliminate critical bottlenecks.

# I

## Introduction

This essay presents an overview of Latin America's economic growth since the 1930s, as well as of its main problems in this regard and the strategies it has employed. This analysis of the last 60 years will revolve around three events, three questions and three hypotheses.

### 1. Three events

It is well known that, increasingly promising indications of a recovery notwithstanding, in the 1980s Latin America experienced the longest, most severe crisis to affect it since the Great Depression of the 1930s. Production bogged down, with the result that the region ended the decade with a level of per capita income almost 10% below the 1980 figure, and inflation soared so high that the region marked up an incredible average annual rate of over 400% for the decade and did not return to its customary, more moderate rates of around 20% until 1992. All this demonstrates just how apt a description of the 1980s is provided by the term "the lost decade".

Second, the economic and social crisis of the 1980s was coupled with a crisis of ideas as the very foundations of the development strategy in use since the 1930s – i.e., industrialization based on import substitution – were called into question. Indeed, the region's development strategy is undergoing a complete turnaround as it shifts from inward-looking to outward-looking growth, from broad-ranging interventionism to a much greater reliance on market forces, and from growth directed by the public sector to growth led by the private sector.

Third, this strategic about-face is taking place despite the fact that between the end of the Second World War and 1980, Latin America grew more rapidly and more steadily than ever before in its history, expanding at a rate of somewhat over 2.5% per year; this was much higher than its historical rate of 1%, although, even so, it was still far below the rates attained by the newly industrializing economies (NIES) of Asia.

### 2. Three questions

Three questions arise. The first is: Why were the 1980s such a disastrous decade for the region? The answer obviously has to do with the external debt crisis and the costly adjustment and stabilization processes that were required in order to deal with the macroeconomic disequilibria it generated.

If the crisis was nothing more than a problem of macroeconomic instability, however, then a second question arises: Why should the region change its development strategy? One answer might be that the import-substitution strategy was a mistake from the very start.

If it is true that the import-substitution strategy was a mistake from the start, then how (and this is the third question) can we account for the fact that the period during which it was applied was also the period when Latin America achieved the most rapid pace of economic growth in its history?

### 3. Three hypotheses

Our first hypothesis is that the 1980s were a lost decade not only because of the region's macroeconomic instability but also because of problems stemming from its development strategy. During the 1970s these problems began to be manifested in declining productivity and an increasing vulnerability to external shocks, but were not expressed outright because of the heavy inflow of capital being received during that time. (This hypothesis is almost universally accepted now.)

The second hypothesis is that, the criticisms of the orthodox school of thought notwithstanding, the import-substitution strategy was not a blunder from the very outset. In fact, it made a great deal of sense during the 1930s, when the contraction of world trade as a consequence of the Great Depression made it nearly impossible to export and the State had to find some way of stimulating a stagnant private sector. And it continued to make sense at least until the late 1950s, since the Second World War made it almost impossible to import manufactures and, later, during

the reconstruction of Europe and Japan, it would have been very difficult to export any significant amount of manufactures because those markets had virtually closed down. In the 1960s, however, the import-substitution strategy started to yield sharply diminishing returns as the "easy" substitution stage came to an end and international trade embarked upon a period of extraordinary growth. (This hypothesis is somewhat more open to debate, but it still probably represents the majority opinion among experts on the subject.)

Our third hypothesis is that what surely does need to be corrected is the orientation of the development strategy so that an outward-looking, rather than inward-looking, approach may be taken. The inward-looking orientation has already fulfilled its function in history. The "infant industry" of today is no longer aiming at production alone, as in the past, but now strives to carve out a place for itself in foreign markets. If there is any justification for an active role for the State, it is the need to promote entry into new markets, especially for non-traditional products. Accordingly, the debate regarding this subject does not refer to the reorientation of the strategy but rather to

the role of the State, i.e., whether outward-oriented growth should be promoted by the State or whether it should proceed without State interference. In the past, the debate was conducted as if there were only two options: (i) an active State combined with inward-oriented growth, or (ii) outward-oriented growth and a passive State. The participants in this debate overlooked the fact that two possibilities along two different axes meant that there were four options, not two. Most importantly, they were ignoring the option of outward-oriented growth in combination with a State that actively promoted that growth, which is not only theoretically possible but is also a characteristic of the development strategy pursued by Japan and the Asian NIES; this is also the option now advocated by ECLAC.

These are, in an extremely condensed form, the three events, three questions and three hypotheses on which this essay is based. In the following discussion, these topics will be explored in chronological order:<sup>1</sup> the origin and implications of the import-substitution industrialization strategy; the crisis of the 1980s and its causes; and the strategic turnaround now being performed by the region.

## II

### The import-substitution industrialization strategy: its origin and its implications

#### 1. Its origin

Between the time the Latin American countries won their independence and the Great Depression of the 1930s, the region's development was based on the pillars of classic orthodoxy: private ownership, market economies and relatively small, passive States. The Great Depression of the 1930s changed all that, however, by giving rise to a deep mistrust of the virtues of the market as a mechanism for automatically resolving major economic problems. In developed countries, the market's ability to generate a rapid, spontaneous solution for cyclical unemployment was called into question. In developing countries, the "confidence crisis" was much greater still, and it came to be believed that therein lay the

reason why Latin America was growing so slowly (about 0.5% per capita since independence, as compared to a 2% rate for the United States) and why its per capita income as of the 1930s was only one-sixth that of the United States, which was also a new territory that had been colonized about the

<sup>1</sup> At this point I should remind the reader that talking about "Latin America" as such is an oversimplification, even though the countries within it have many similarities. The structures and sizes of the different Latin American economies vary substantially. Furthermore, no matter how alike their development strategies may have been, the focuses and intensities of those strategies have differed considerably. A somewhat stylized representation of those strategies will help us to bring out some important points in the course of this discussion, but no actual country in the region behaves exactly like the "typical country" to which it refers.

same time as Latin America. Hence the market, private ownership and a small, passive State did not, in and of themselves, automatically lead to economic development.

The questioning of this state of affairs gave rise to the idea that the State, especially in a region of belated growth, should play an active role in overcoming "structural" problems (e.g., a lack of entrepreneurial drive, exceedingly imperfect markets, a concentration of power and wealth, etc.) that hold back its economic development. This idea ran counter to the premise, which until then had been generally accepted, that the State should play a passive role, or at the very most should act as no more than a facilitator for private activity. Moreover, in view of the close correlation between per capita income and the level of industrialization (regardless of which might be the cause and which the effect), it was concluded that the State should make a special effort to promote industrialization, since it was this process that appeared to be the primary vehicle for technological progress. Thus, as a consequence of the depression of the 1930s, the active promotion of industrialization came to be seen as a special function of the State, and the region abandoned what had until then been the orthodox strategy of outward-looking development based on commodity exports.

Nevertheless, the choice of an inward-looking industrialization strategy rather than an outward-oriented one appears to have been an accident of history, rather than the outgrowth of any particular theoretical stance.<sup>2</sup> The Great Depression of the 1930s and the region's deteriorating terms of trade made it more difficult to import manufactures and thus more attractive to produce them domestically. In

<sup>2</sup> The theoretical argument for an industrialization strategy based on import substitution was formulated by Raúl Prebisch and ECLAC many years after the implementation of that policy. In his famous call for industrialization, Prebisch justified it by pointing to the supposed asymmetries existing with respect to the benefits of the dissemination of technological progress. In raw materials-producing countries, the fruits of such progress are quickly passed on to consumers via price declines, whereas technological inroads in the manufacturing sector generally lower costs but not prices owing to the oligopolistic structure of markets for manufactures. Hence the long-standing downward trend in the terms of trade for raw materials producers, such as the countries of Latin America (see ECLAC, 1949). Of course, other authors—including W.A. Lewis in what has become a classic essay (Lewis, 1963)—also championed the cause of industrialization, but it was Prebisch's argument that had the most influence in Latin America.

addition, the marked protectionism of the industrial countries during that crisis made an outward-looking form of industrialization unthinkable, while shortages of manufactures unrelated to the war effort and the difficulty of importing such products during the Second World War naturally set the scene for their domestic production. Furthermore, the presence of exchange controls and the tariff protection that characterized the period of European and Japanese reconstruction also made it unfeasible for Latin America to adopt an outward-oriented industrialization strategy during those years. It therefore comes as no surprise that the region opted for an inward-looking strategy based on import substitution. This was reinforced by the virtually "natural" sequence of events whereby the countries' industrialization would first be based on the domestic market and only later, once experience had been gained, would exports come into the picture.

## 2. Policies and their outcomes

The import substitution-based industrialization strategy made use of a wide variety of instruments. The chief such tool was tariff protection, which was generally greater for final products than for intermediate inputs, and less for capital goods. This protection was usually supplemented by such measures as quotas and import permits, total bans, national content requirements applying to the value added during production, soft loans (often at interest rates that were negative in real terms) and others.

### a) Progress

Actually, the region turned in a good economic performance during the period 1945-1980—surprisingly good, considering how harshly the import-substitution strategy has been criticized. In fact, the annual per capita growth rate for the gross domestic product (GDP) was 2.7% for the period in question (see table 1). This rate was unusually high for the region; indeed, not only was it far above its previous historical rate (1% per year), but it was actually even higher than the 2.5% per year target set by the Alliance for Progress in 1960. What is more, it was accompanied by a relatively moderate rate of inflation of 20% per year; in fact, 11 countries averaged single-digit rates and no country experienced triple-digit inflation.

TABLE 1

**Latin America: growth and inflation, 1945-1992**  
(Annual percentages)

	Growth of gross domestic product				Inflation		
	1925-1945	1945-1980	1980-1990	1991/1992	1945-1980	1980-1990	1992
Latin America	3.5	5.6	1.2	3.2	20	Over 400	Under 20 <sup>a</sup>
Per capita GDP	1.0	2.7	-0.9	1.1			410 <sup>b</sup>
Argentina		3.1	-1.5	6.7	57	650	18
Bolivia		3.4	-0.7	3.8	28	1 000	11
Brazil		6.9	1.9	-0.3	33	450	1 130
Colombia		5.2	3.5	2.6	14	23	26
Costa Rica		6.7	2.1	2.6	6	28	18
Chile		3.6	2.7	7.7	77	21	13
Ecuador		6.8	2.1	3.9	8	40	66
El Salvador		5.1	-0.6	3.9	5	19	17
Guatemala		4.6	0.5	3.6	4	12	12
Haiti		1.3	-0.5	-2.7	5	5	18
Honduras		4.4	1.8	3.4	4	6	6
Mexico		6.7	1.2	3.1	9	70	13
Nicaragua		4.7	-1.3	-	6	5 000	2
Panama		5.3	-1.0	8.3	3	3	1
Paraguay		4.8	3.0	1.9	22	20	17
Peru		5.1	-1.0	-0.3	17	1 000+	6
Dominican Republic		6.2	2.5	3.3	2	22	5
Uruguay		2.6	-0.4	4.3	36	57	59
Venezuela		6.7	-0.2	8.9	5	26	33

Source: ECLAC, Division of Production, Productivity and Management.

<sup>a</sup> Preliminary figures; Brazil is not included.

<sup>b</sup> Preliminary figures; Brazil is included.

This growth trend was led by the manufacturing sector (see table 2), whose share of GDP climbed from 14% in 1930 to 25% in 1980. As was to be expected, imports' share of GDP slipped from 20% in 1930 to 15% in 1980 and the region became less dependent upon them.

The region's social progress was perhaps even more impressive than its economic achievements (see table 2). Despite the post-war population explosion, adult illiteracy dropped from 45% in 1945 to 20% in 1980. Indeed, education—which in 1945 had been a clear reflection of a classist society in which opportunities for utilizing educational services were limited—expanded enormously. Primary education's coverage became virtually universal, and access to what until then had been the remote possibility of post-primary education was opened up; as a result, the percentage of young people of the corresponding ages who were enrolled in secondary educational institutions trebled and the percentage in higher education increased fivefold. Enormous progress was made in providing the population with drinking water and

electricity in the home as well, with the coverage of these services expanding to include two thirds of the population (as compared to one third or less in 1945). Life expectancy at birth increased by 15 years to 65 years of age by 1980, which was not much less than the figures registered for many developed countries. It is also important to note that all these social advances were progressive, i.e., severely underprivileged social groups benefited much more than others, since wealthier classes had long enjoyed most of these services. This improved distribution of social benefits (or non-monetary income) partially offset the concentration of monetary income that tended to be a characteristic of post-war economic growth.

#### b) Problems

Although the region's economic and social performance during its implementation of an industrialization strategy based on import substitution certainly was impressive, it was actually so only in comparison to its past performance. Indeed, it seems quite

TABLE 2

**Latin America: social and economic indicators,  
1930, 1945 and 1980**  
(Percentages)

	1930	1945	1980
<i>Economic indicators</i>			
Manufacturing-sector GDP/GDP	14	18	25
Imports/GDP	20	13	15
Traditional exports/total exports	Over 88	Over 82	76
<i>Social indicators</i>			
Adult illiteracy		45	20
School enrolment rates			
Primary education		55	90
Secondary education		10	30
Higher education		2	10
Life expectancy at birth (in years)		50	65
Percentage of dwellings with:			
Running water		20	65
Electricity		35	70

Source: ECLAC, Division of Production, Productivity and Management, on the basis of figures from ECLAC, the World Bank and the United Nations Children's Fund (UNICEF).

lackluster if it is compared with the opportunities for rapid growth available to late-developing countries—opportunities which the Asian NIES used to achieve a growth rate more than double that of Latin America during the same period.

In fact, there were a number of signs that the import-substitution strategy was becoming increasingly problematic for the region. First of all, as the substitution process moved on from final products (which are easier to find replacements for) to the production of intermediate inputs and capital goods, it became more and more expensive and inefficient. The productivity of capital (the scarce factor in this case) declined either because plants were too large for the size of their market, or because they were underutilized, or because their technological requirements and quality standards were too sophisticated for the region's production capacity. Thus, the marginal capital-output ratio climbed steadily, from around 4 in 1950-1965 to over 5 in 1974-1980 and to more than 8 by the 1980s. In fact, a recent study (Hofman, in press) of trends in total factor productivity,<sup>3</sup> or technological improvements, in various regions of the world between 1950 and 1989 indicates that it had been falling sharply in Latin America since 1973 (see figure 1). Thus, GDP grew during this period

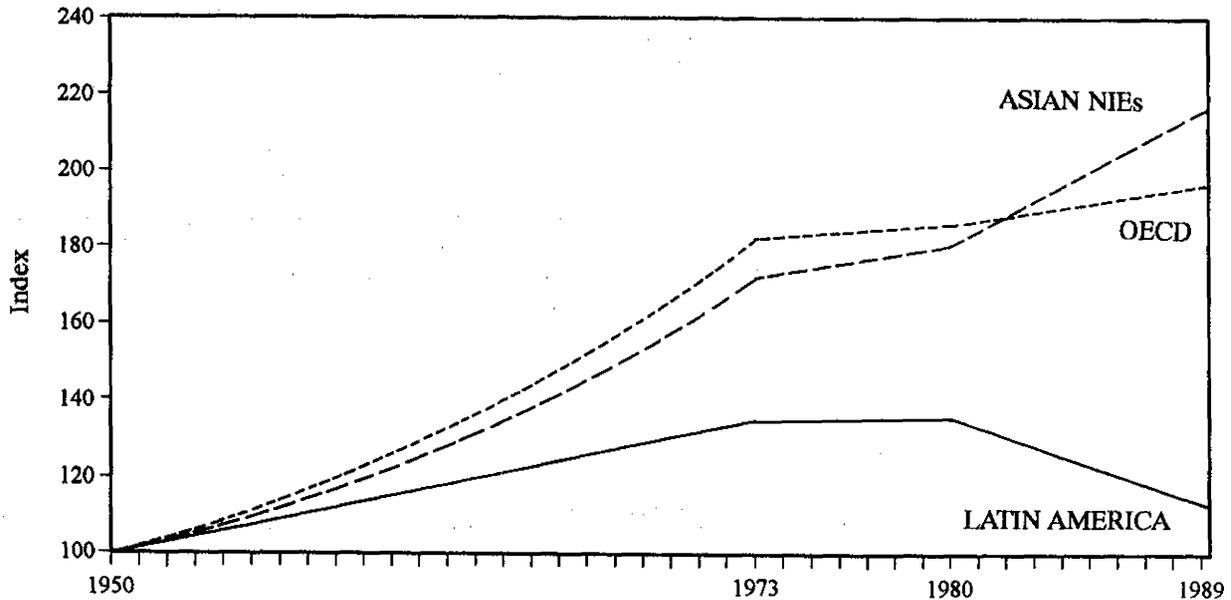
only because there was a larger supply of factors, especially capital (from external borrowing), since there was no increase in efficiency during the period 1973-1980 and it actually decreased during the 1980s. In contrast, total productivity, or efficiency, grew far more in the Asian NIES: 2% per annum for the period as a whole, as opposed to just 0.3% in Latin America. Even during Latin America's "golden age" (1950-1973), total factor productivity in the region grew by only one half as much as in the Asian NIES (annual rates of 1.3% versus 2.7%).

Second, precisely because of its import-substitution strategy, the region became extremely vulnerable to external shocks. Since, by reducing imports, tariffs cause the real exchange rate to move downward, import substitution is an implicit tax on exports and is particularly a hindrance for non-traditional exports. Hence the fact that exports' share of GDP in 1980 was not only small (15%) but was also primarily accounted for by traditional exports (75%) that were

<sup>3</sup> The term "total factor productivity" refers to the ratio between output and all factors of production (rather than any single factor), including both capital and labour, with each factor being weighted according to its share in total output.

FIGURE 1

**Total factor productivity: Latin America, Organization for Economic Cooperation and Development (OECD) and newly industrializing economies (NIEs) of Asia**  
(Indexes: 1950 = 100)



Source: A. Hofman, *Economic Development in Latin America in the 20th Century. A Comparative Perspective*, in S. Adams, *et al.* (eds.), *Explaining Economic Growth. Essays in Honor of Angus Maddison*, Amsterdam, Elsevier/North Holland (in press).

generally price inelastic for both demand and supply. Consequently, non-traditional exports represented less than 4% of GDP.

Third, in practice, tariff protection was excessive in every sense and had no more economic justification than an attempt to offer each sector the protection it wanted. As may be seen from table 3, this protection was grossly excessive, unusually disperse and clearly tended to be used as a permanent, rather than temporary, measure. Effective protection generally verged on or exceeded 100%, which was far greater than any sort of distortion that it might reasonably be expected to offset. Merely as an example, even if urban wages (for the reasons adduced by W. Arthur Lewis) were to exceed the real or social scarcity price of labour by as much as 50%, and if wages were equal to 30% of costs, this would justify a countervailing tariff of no more than 15%. Similarly, cross-sectoral or cross-country tariff dispersion had no solid economic or social basis; effective protection was often low or even negative for labour-intensive items such as food products, but was

extremely high for capital-intensive products (i.e., products intensive in a scarce factor), such as consumer durables.<sup>4</sup> Protection was also highly discretionary, since there were many exceptions, and tariff revenues on total imports were therefore much lower than the average nominal tariff.

Despite all these problems, the benefits of import substitution outweighed its costs at least until 1973; hence the sharp acceleration of the region's economic growth during the post-war period. This was because, at least until the late 1950s, the relative prices of manufactures were clearly an incentive for their production, while the protective measures being used by most industrial countries in the 1930s, during the Second World War and during reconstruction would have made an outward-oriented industrialization strategy quite

<sup>4</sup> Effective protection for electrical goods was 195% in Argentina in 1969, 609% in Uruguay in 1976 and 740% in Chile in 1967 (Ramos, 1989).

TABLE 3  
**Latin America (six countries): effective protection  
 and tariff spreads in the late 1960s**  
*(Percentages)*

	Effective protection	Tariff spread
Argentina	95	-10 to 1 300
Brazil	80	4 to 250
Chile	220	-23 to 1 100
Colombia	90	-8 to 140
Mexico	39	-4 to 1 000
Uruguay	385	17 to 1000

Source: R. Ground and A. Bianchi, 1988.

impractical. Even in the 1960s, the inward-oriented strategy was not too costly (except for the fact that it caused the region to miss a splendid opportunity for adopting an outward-looking orientation at a point in time when world trade was about to enter into a stage of extraordinarily rapid growth) so long as the substitution process was still chiefly in its easier stages. And a learning process was also clearly taking place which led to greater productivity, less inefficiency and lower costs. The net result of all this was that, even though the region should have started to reorient its strategy towards an outward-looking stance in the 1960s, the period 1945-1980 was still the time of the greatest economic and social growth in the region's history.

### III

## The crisis of the 1980s and its causes

Why, after 35 years of solid, steady –if not spectacular– growth with moderate inflation, were these accomplishments wiped out in the 1980s by recession and stagnation, on the one hand, and an almost across-the-board outbreak of inflation, on the other?

#### 1. The main events

The economic crisis of the 1980s was so severe that, far from growing during the period, the region's per capita GDP fell to a point where, by 1990, it was nearly 10% lower than it had been in 1980. In fact, an increase –and a very modest one at that– was seen in only three countries (Chile, Colombia and Paraguay), while decreases were registered in all the rest; in some cases, the drop amounted to over 20% (Argentina, Bolivia, Haiti, Nicaragua, Peru and Venezuela). It was not until 1991-1992 that signs of a recovery began to be observed (see table 1).

During the 1980s the region also witnessed an exceedingly strong upsurge in inflation. In the period 1945-1980, the region's average annual rate of inflation had been 20%, and in 11 countries it was under 10%, but in the 1980s the average rate shot up to over 400% and only three countries held

their annual average rates of inflation down to one digit. Thus, inflation became endemic in virtually the whole of the region: eight countries recorded annual rates of over 100% –an unprecedented state of affairs for the region– and three of them (Bolivia, Nicaragua and Peru) experienced hyperinflation, with average rates of inflation reaching four-digit levels for the decade.

#### 2. The causes

Clearly, the crisis of the 1980s was caused by the external debt problem. Earlier, however, we postulated (as our second hypothesis) that the severity and protracted duration of that crisis stemmed not only from the disequilibria generated by the external debt overhang and faulty macroeconomic management, but also from the region's extreme vulnerability to external shocks in 1980 owing to its import-substitution strategy.

Briefly, the recession and stagnation of the 1980s, as well as the inflationary spiral seen at that time, arose out of the region's difficulties with respect to resource transfers, in terms of both out-bound transfers from the region and transfers from the public to the private sector. The reversal of the region's net resource transfers was equivalent to 6%

of GDP; in other words, whereas prior to the crisis the region had been a net recipient of resources amounting to about 2% of GDP, by its end the region had become a net supplier of resources representing around 4% of GDP.

The severity of this recession is attributable to the fact that it was impossible to carry out an "efficient" adjustment of the required magnitude by expanding non-traditional exports, since the level of such exports was exceedingly low owing to the implicit disincentive generated by protectionist policies; nor was it possible to substitute non-essential imports, since the policy of substitution had already whittled such imports down to a bare minimum. Accordingly, the adjustment had to be a recessionary one, with draconian cuts in imported intermediate inputs and capital goods that were needed for production.

The inflationary spiral, for its part, was caused by the fact that the public sector had to absorb the lion's share of the cost of the region's outward resource transfer. Since it had little leeway in which to raise its revenues and little desire to reduce what were regarded as essential expenditures, in most cases the public sector resorted to money creation in order to "finance" its deficit.

The economy's post-1983 stagnation was a result, on the one hand, of the instability generated by high inflation rates and, on the other, of the recessions that generally accompany stabilization programmes that lack credibility or are poorly managed.

At a more detailed level, it is useful to distinguish among three phases in the crisis of the 1980s. The most salient aspect of the *first phase*, from 1979 to 1981, was the increase in oil prices following the fall of the Shah of Iran. This sparked the simultaneous implementation of inflation-control programmes in the developed countries, whose inflation rates as of 1979 had still not dropped back to the levels recorded prior to the first oil crisis. These countries not only gave priority to anti-inflation policies, but, under the influence of the monetarist approach that prevailed at the time, they all also adopted targets for the expansion of the money supply while allowing interest rates to find their own level. As a result of this decision, the LIBOR (the rate to which the region's external debt was tied) jumped by nearly 10 points between 1978 and 1981 to a high of 17% in the latter year. A final factor was that the

implementation of such harsh stabilization programmes led to recessions or economic stagnation in the central countries, which had an adverse impact on raw material prices. The region's oil-importing countries were thus subjected to three severe exogenous shocks: an increase in the price of their oil imports (oil made up 40% of Brazil's imports, for example); a steep rise in interest payments on their external debt; and a decline in the prices brought by their export products. As becomes evident upon examination of the various components of the balance of payments (see figure 2), the countries either had to cut back sharply on their imports (which would be quite difficult since so few imports were non-essential), boost their exports (a slow process, especially since any expansion of traditional exports would tend to push down their prices, particularly during a time of worldwide stagnation), or increase their borrowing. Given these options, it comes as no surprise that all the countries (except Colombia) chose to increase their borrowing. What is considerably less understandable, however, is why the banks approved these requests and readily granted loans to oil exporters (countries which were apparently well able to service larger loans) and oil importers (which found themselves in straitened circumstances) alike. The end result was that the region's external debt climbed by 85% during the period 1979-1981.

Of all the oil importers, only Brazil invested a significant portion of the borrowed funds (primarily in import substitution, which eased its adjustment when capital inflows began to dry up in 1982). The other countries wagered that the crisis was a cyclical, short-lived phenomenon and thus used the funds to maintain their existing consumption levels or, particularly in the case of the Southern Cone countries, to boost their imports, at pre-set exchange rates, and thus help to lower inflation (which led to increasingly undervalued real exchange rates). The oil exporters, for their part, did raise their investment rates, but much of these investments were made in poorly designed, overpriced projects. They also devoted a generous share of the borrowed funds to consumption, in expectation of receiving a much higher level of income on a permanent basis. Therefore, when oil prices started to edge downward rather than continuing to climb as they had expected, these countries' capacity for servicing their public sectors'

FIGURE 2

## Latin America: balance of payments components

1.	INBOUND FOREIGN EXCHANGE	=	OUTBOUND FOREIGN EXCHANGE
2.	EXPORTS + NEW CREDITS (NET INCREASE IN EXTERNAL DEBT)	=	IMPORTS + INTEREST PAYMENTS
3.	$P_x Q_x$ + $\Delta D$	=	$P_m Q_m$ + $iD$
4.	$\Delta D$ - $iD$ (NET INCOMING RESOURCE TRANSFER)	+	$P_m Q_m$ - $P_x Q_x$ (IMPORTS - EXPORTS, OR TRADE DEFICIT)

Source: ECLAC Division of Production, Productivity and Management.

external debts collapsed, and a considerable portion of these (public-sector) borrowings took the form of (private) flight-capital. This capital flight cut deeply into international reserves, making it impossible to continue propping up the exchange rate. Hence Mexico's moratorium in August 1982.

The Mexican moratorium marked the beginning of the *second phase* of the crisis of the 1980s (1982-1983). The reaction to the moratorium was a sharp drop in bank loans to the entire region, with the result that net resource transfers did an about-face from a net inflow to the region equivalent to 2% of GDP to a net outflow equivalent to 4% of GDP. The impact of a reversal of this magnitude in the direction of flow can hardly be overemphasized. It may suffice to note that the sum involved exceeded the draconian war reparations imposed on Germany by the Treaty of Versailles following that country's defeat in the First World War.

The only way the region was able to finance that reversal in the transfer of resources was by moving from a trade deficit of US\$13 billion in 1981 to a trade surplus of US\$27 billion in 1983.

Obviously, changing the trade balance by the equivalent of 6% of GDP in just two years could only be accomplished by relying primarily on a drastic reduction in imports (the volume of imports dropped by 40% in those two years), rather than a rise in exports. After all, no matter how costly it may be to cut back on imports used in production, they can be reduced as much as necessary right away, whereas expanding exports (obviously the more desirable way to go about making an adjustment, since it does not entail a drop in production) is necessarily a slower process because it requires prior investments as well as time in which to win over external markets.

The difficulty of making a non-recessionary adjustment by increasing exports and reducing unessential imports was heightened by the region's extreme vulnerability to external shocks. As a result of the import-substitution strategy, non-traditional exports (in most cases, the only ones that could be increased significantly without affecting their price) represented less than 4% of the region's GDP; moreover, the substitution process had advanced to the point where the imports that

the region could most easily do without –i.e., consumer goods (many of which, actually, were food and medicine that were not really so dispensable)– made up less than 2% of GDP. In order to make an adjustment equivalent to 6% of GDP in the space of just two years, the region would therefore have had to double its non-traditional exports and completely eliminate all imports of consumer goods –which was clearly impossible. Consequently, the adjustment was based on a severe, costly reduction of imports of intermediate inputs and capital goods, both of which were essential for the region's production activities.

In contrast, a non-recessionary adjustment based on an expansion of non-traditional exports was a much more feasible proposition for the Asian NIES because these products constituted 30% of their GDP and were composed almost entirely of manufactures, and therefore enjoyed relatively high price elasticities of demand. Thus, an adjustment equalling 6% of GDP based on an increase in a category of exports representing 30% of GDP called for the much more reasonable effort of raising exports by 20% in two years. We can therefore see how the outward orientation of these economies put them in a much better position for carrying out a non-recessionary adjustment, in sharp contrast to the Latin American countries. The latter's vulnerability to external shocks following an overlong period of import substitution made it very difficult for the region to adjust to the debt crisis, and this is part of the reason for the turnaround in the orientation of its growth strategy which began to take place in the 1980s.

The *third phase* of the crisis (1984-1990) was marked by near zero-growth in the economy along with unbridled inflationary spirals. Both of these phenomena were closely related to a second resource-transfer problem: the domestic transfer of resources from the public sector to the private sector. By this time, 75% of the region's external debt was public-sector debt, partly because the public sector had incurred debts on its own prior to the crisis (50%) and partly because circumstances had made it necessary for the public sector to assume a large portion of the private sector's external debt (another 25%). Thus, of the six points of GDP represented by the reversal in resource transfers, more than four points corresponded to the public sector. Since public revenues constituted only

around 20% or 25% of GDP, it was almost impossible for the public sector to absorb another four points, especially since the vast majority of the countries in the region already had fiscal deficits when the crisis began. Consequently, with the notable exceptions of Chile and Colombia, they had to "finance" these increased resource requirements, at least to a large extent, through money creation. Since the ratio between the money supply (M1) and GDP was approximately 5%, it is not surprising that increases in the deficit and in money creation amounting to around four points of GDP led to a dramatic upsurge in inflation. The larger deficits, together with the cost pressure exerted by steep devaluations, triggered inflationary spirals which, especially in cases where automatic indexation mechanisms were in operation, often pushed the economy into hyperinflation.

The stagnation or recessions that were characteristic of this phase were largely due to the instability caused by runaway inflation; this is what happened in Argentina (1988-1990), Bolivia (1982-1985), Brazil (1990-1991), Nicaragua (1987-1990) and Peru (1988-1990). Other recessions stemmed from anti-inflationary programmes that were poorly designed or lacking in credibility (Venezuela in 1989 and Peru in 1990). Indeed, although both theory and experience (e.g., Mexico in 1988, Argentina in 1991 or Israel in 1985) demonstrate that it is possible to lower inflation without causing a recession, stabilization efforts often do have highly recessionary effects if the programmes lack credibility and expectations far outstrip the stabilization plan's inflation targets or if fiscal restraint is based to a disproportionate extent on spending cuts rather than increases in revenue.<sup>5</sup>

<sup>5</sup> Since spending cuts are usually concentrated in just a few items (public-sector wages or investment) but increases in revenues are usually more widely and evenly distributed, a reduction of the fiscal deficit based on increases in fiscal revenues is likely to slow down the rise in prices rather than to dampen production, whereas reductions in expenditures, because they are so highly concentrated, will almost inevitably lead to a drop in output.

## IV

### The strategic turnaround of the late 1980s

Just as the Great Depression of the 1930s sparked increasing mistrust of the virtues of market mechanisms and thus led the State to adopt an active industrialization strategy based on import substitution, the crisis of the 1980s brought to light the limitations of both an over-extended State and an inward-looking development strategy. This prompted a turnaround in strategy which led to the adoption of an outward orientation, a greater use of market mechanisms and a redefinition of the roles of the private and public sectors whereby production was reserved for the former and the latter tended to be confined to its most essential functions and to highly selective intervention only in cases of major flaws in the market.

#### 1. The events

The first important event was the region's initiation of an about-face in its development orientation as it shifted its attention away from the domestic market and towards the external market (ECLAC, 1992, table II-1). This has led to the following: (i) the region's nominal average tariff has been lowered from 45% to under 20%; (ii) the tariff structure has been greatly simplified and streamlined (from as many as 30 different rates it has been reduced to no more than seven) and in some cases a uniform tariff is applied to all imports; (iii) many non-tariff barriers have been dismantled and replaced with tariffs (e.g., in Mexico the percentage of imports subject to advance permit requirements has been reduced from 90% to less than 20% and in Argentina it has been lowered from over 60% to less than 20%); and (iv) interregional integration (with Canada and the United States) and intraregional integration (MERCOSUR) processes, as well as some bilateral accords (Chile with Mexico, Venezuela and possibly Costa Rica, and Colombia with Venezuela), are making great inroads and are now generally using the tariff rates of the country having the lowest levels as a basis (in the case of common markets, rather than free trade zones).

Second, economic agents have come to have a greater appreciation of the merits of the market—with all its imperfections—because now they are comparing its performance with that of a real public sector (which has its own limitations and imperfections) rather than with some utopian vision of State intervention. The prevailing attitude now is a more pragmatic one directed towards improving both the market and State action rather than towards expanding one at the expense of the other. The great majority of price controls have been lifted thanks to the realization that such controls are at best short-term palliatives which, if allowed to remain in place, will ultimately have an adverse impact on resource allocation. For this reason, in addition to the fiscal crisis, the vast majority of direct and implicit subsidies have also been eliminated. All the countries of the region have also rejected the idea of keeping interest rates at negative levels in real terms, although there is some disagreement as to how freely these rates should be allowed to float once they rise above the real LIBOR plus some sort of surcharge to reflect their status as developing countries in which capital is particularly scarce.

Third, the roles of the public and private sectors have been redefined, and the preeminence of the latter as an agent of production has been acknowledged. This has prompted an extensive move to privatize State-owned firms not only in competitive activities such as manufacturing, banking, agriculture, mining and transport where there is little justification for State control of production, but also in monopolies such as telecommunications and electricity generation and transmission systems, for which private operation in combination with government regulation is considered to be the best option. Only large enterprises devoted to the extraction of natural resources (such as oil in Mexico, Venezuela and Ecuador or copper in Chile) have generally been left in the hands of the public sector owing to the fact that, because they generate such a large percentage of the region's exports, they inevitably have an influence on macroeconomic variables. The

corporate sales associated with these privatization processes generated (one-time) income for the Treasury amounting to about 4% of GDP per year in Argentina during the 1990-1991 biennium, around 1.6% of GDP per year in Chile during the period 1986-1989, approximately 2% of GDP per year in Mexico in 1990-1991, and around 4% of GDP in Venezuela in 1991; in the rest of the countries, the income from such sales has not yet reached significant proportions.<sup>6</sup>

## 2. Areas of agreement and disagreement

### a) Areas of agreement

There is now some degree of consensus about the need for the region to position itself in the international economy. Certainly, from a neoliberal perspective, import substitution was a mistake from the very outset, since the economy should always have been oriented outward. The neostructuralists, for their part, feel that import substitution-based industrialization made sense under the circumstances prevailing in the world from the time of the Great Depression of the 1930s up to at least the late 1950s, but they have always regarded this strategy as an initial stage of the industrialization process. They therefore believe that the necessary learning process was allowed to go on too long and that now it is time to take advantage of the industrial base created during that process while changing it over to an outward-looking orientation. This would allow the region to take advantage of the production know-how it has acquired, the stimulus to attain higher levels of quality and efficiency which is generated by international competition, and the economies of scale available in external markets, especially for small countries.

<sup>6</sup> These privatization processes have by no means been problem-free, however, due in particular to their insufficient transparency, the Governments' haste to make the sales, the conclusion of sales during times of crisis, the lack of a sufficient number of potential buyers to make the bidding truly competitive and a lack of clarity about the regulations to apply to the activities in the future. All these problems depress the sales price and, hence, make the Treasury's proceeds less than they would have been if the sale of these firms had been based on their actual value to potential buyers rather than their prior (lower) value for the Government (because of their previous bureaucratic, inefficient form of management). For a thorough analysis of this subject and information on the sums involved, see Devlin, 1992.

FIGURE 3

### Development orientation and role of the State

	Outward development	Inward development
Passive State	Orthodox position	
Active State	Current ECLAC position	Past ECLAC position

Source: ECLAC Division of Production, Productivity and Management.

There is also agreement that, just as the market has flaws, State intervention, too, has its limitations, especially when it encompasses too many different spheres. When the State becomes over-extended, it usually ends up doing a poor job even in those functions which are inarguably its exclusive responsibility (e.g., maintaining macroeconomic equilibria, providing access to an acceptable quality and quantity of educational and health services and social security, and ensuring the safety of the general public). Hence the recognition of the production function as essentially within the purview of the private sector and the disavowal of the notion of an entrepreneurial State; this probably implies a smaller State in terms of expenditure, but a larger one in terms of income if it is to be an efficient, modern State that performs its essential functions satisfactorily.

### b) Areas of disagreement

There continues to be disagreement, however, on the following major points: (i) *The role of the State*: Should it be active (and if so, how active) or passive? (ii) *The extent of outward orientation*: Will neutral incentives (a high exchange rate and low, uniform tariffs –or no tariffs at all) suffice or is a temporary pro-export bias necessary? (iii) *Social equity*: Can

growth be coupled with an increase in social equity or are growth and social equity necessarily mutually exclusive objectives? And, if that is the case, then will it be necessary to wait for the benefits of growth to “trickle down” to the needy or should we mitigate this clash between the two objectives by means of compensatory social policies? and (iv) *The type of instrument*: Is it simply a question of having the “correct” prices (i.e., allowing prices to be freely determined) or are more aggressive promotional policies needed to deal with the most critical bottlenecks?

(i) *An active or passive role for the State*. Neo-structuralist thinking—and certainly that of ECLAC—on this point recognizes, in no uncertain terms, the urgent need for the region to increase its share in international trade at the present time. Unlike the contemporary orthodox school of thought, however, it holds that this task, as well as the promotion of development, calls for an active State (see figure 3). What is more, in order to penetrate external markets—the challenge now facing the region—much more stimulus and cooperation appear to be needed from the State than were required to carry forward the import substitution process.

In more general terms, the history of Latin America and other developing regions clearly indicates that although the market and private ownership are necessary conditions for development, neither growth nor social equity are automatic results of a naturally-operating market. On the contrary, in economies which have been relatively late to develop (such as Japan, the Republic of Korea and the Chinese province of Taiwan), the State has played a major role in helping those economies to leapfrog various stages of development and to grow at remarkably rapid rates while at the same time ensuring that the population receives an ample share of the fruits of that development.

Furthermore, we know that it is not only the market that suffers from imperfections; after the State has performed its basic economic functions satisfactorily (macroeconomic stability, infrastructure and social investment, basic social security), it, too, has only a limited amount of capacity remaining. State intervention must therefore be highly selective and must address important development issues, such as export promotion, the achievement of higher saving rates, the improvement of the capital market, the dissemination of technology

and others specific to each case. Unlike past approaches, however, when State intervention was not only excessive but also tended to supplant market forces, the present view is that intervention should not only be selective but should also, in every case, bolster the operation of the market. It is thus not a question of having “more State” or “more market”, but rather of having a better State and an increasingly effective market.

(ii) *The extent of outward orientation*. The typical formula for achieving an outward orientation—maintenance of a high, stable real exchange rate and of low tariffs that are as even as possible—does nothing more than to blunt the anti-export bias of a protectionist policy, but so long as tariffs (at least the permanent ones) are not brought down to zero, that anti-export bias will persist. Even drawbacks will not completely offset it unless their coverage is expanded to include all “indirect exports” (i.e., the products made by national industries to supply inputs for the production of exports).

But the key question is whether a set of neutral incentives is enough or whether the present situation calls for a temporarily pro-export bias. In the past, infant industries produced for the domestic market and the most suitable instrument for promoting them was a protective tariff; now, neostructuralism sees today’s infant industries as poised to penetrate external markets with non-traditional exports. It therefore proposes that a set of special incentives having a temporarily pro-export bias (e.g., larger drawbacks, credit at international rates, tax exemptions) should be created for new or pioneering exports or as a means of opening up new export markets. Blazing a trail in these two directions demands a highly innovative effort that will impose significant externalities upon other producers; these Schumpeterian innovators therefore deserve a premium analogous to the one awarded to a technological innovator under today’s patent laws.

(iii) *Social equity*. The various schools of thought differ considerably on this point. According to the trickle-down theory derived from Kuznets’ studies, something analogous to the “law of the jungle” comes into force, at least during the early stages of development, whereby economic growth inevitably leads to a deterioration in income distribution.

Apart from the fact that the length of time needed for the trickle-down process to take effect may be socially unacceptable, a number of recent empirical

studies have cast doubt upon the conclusion that such a conflict is unavoidable.<sup>7</sup> Another school of thought (espoused by, among others, the World Bank) allows for the possibility of a conflict between growth and social equity but argues that the social benefits of a better distribution may well be worth the price of slower growth. This school of thought usually endorses a "parallel" strategy whereby economic policy is focused on economic growth and social policy on compensating for the economic policy's distributive effects. The problem is that, in practice, social policy is rarely able to offset the regressive effects of at least some types of economic policies. Hence, a third approach (advocated by ECLAC, among others) has been developed.<sup>8</sup> This school of thought contends that the relationship between growth and social equity entails significant areas of complementarity, as well as conflict. This is exemplified by policies such as the maintenance of macroeconomic equilibria, investment in human resources and the promotion of permanent, productive jobs. Thus it is indeed possible for an economy to grow while at the same time increasing social equity if the policies being applied reinforce areas of complementarity and mitigate conflicts in areas where the two objectives appear to run counter to one another. This brings us to an integrated approach in which economic policy incorporates distributive goals as well as growth objectives and social policy incorporates considerations of efficiency as well as of equity, thereby permitting growth and increased social equity to be attained simultaneously (rather than sequentially, as was usually posited in the past).

<sup>7</sup> One of the classic arguments is that development requires an increase in investment and, since only the rich tend to save, then in order to boost saving and, hence, investment, it is necessary to transfer resources from those who save very little (the poor) to those who save a great deal (the wealthy). The truth of the matter is that Kuznets' thesis is an empirical finding for which this and other explanations were sought to serve as a foundation. In fact, the experiences of the Asian NIEs contradict it. Furthermore, the evidence presented by Kuznets was primarily drawn from countries that began their growth during the nineteenth century. It does not take into account the situation of recently industrializing countries, which are less dependent upon investment for their growth because they can leapfrog various stages by taking advantage of technologies developed by others. One recent study that denies the existence of any consistent relationship between growth and social equity is that of Fields (1991).

<sup>8</sup> See, for example, ECLAC (1992).

(iv) *Types of instruments.* Major differences of opinion exist as to which instruments are the most appropriate. Almost without exception, orthodox theorists place emphasis on decontrolling prices and on deregulating markets and making them more flexible. This is because, in their view, underdevelopment is essentially caused by government intervention in the market; an assumption implicit in this proposition is that a freely-determined price in a deregulated market is the "correct", equilibrium, price. Neostructuralists, on the other hand, believe that markets have major flaws which can cause them to generate a freely-determined price —i.e., one that balances supply and demand at any given point in time— that is not necessarily the equilibrium price, which is the price that reflects the actual scarcity of goods and, most importantly, factors. For example, the absence of a currency futures market causes the exchange rate to be extraordinarily variable; State intervention in order to determine the price of the dollar (a particularly crucial aspect at the present time) would therefore be justified if that intervention would simulate the effect of the missing futures market, smooth out the fluctuations in the dollar's value and help guide medium- and long-term investment. By the same token, given the pivotal importance of external-market penetration for the region's development, there may be grounds not only for maintaining a high, stable exchange rate with low, fairly uniform tariffs, but also, as mentioned earlier, for the provision of temporary subsidies for non-traditional or pioneering exports or for opening up new markets (see table 4).

In order for a country to develop it must also raise its saving rates and allocate capital to the most profitable projects. In order to accomplish this, orthodox theory stresses the importance of decontrolling interest rates. Certainly, the negative interest rates observed in the past discourage saving. Experience shows, however, that once these rates have reached a positive level, saving is fairly insensitive to further increases (owing to the counterbalancing effects of substitution and income). In order to raise saving rates further, policy makers will have to resort to "compulsory saving" measures, whether through heavier taxation or more institutional saving (e.g., increasing the rate of social security contributions). In either case, there will be State intervention.

TABLE 4

**Neoliberal and neostructural approaches:  
differences in terms of policy tools**

Key areas	Neoliberal tools	Neostructural (ECLAC) tools
1. Exports	Neutral: high exchange rate and low tariffs	The same, plus temporary bias in favour of non-traditional exports, especially new or pioneering products, and the penetration of new markets
2. Saving (increase)	Reduce expenditure	Increase currently light tax load of private sector (broaden tax base and reduce tax evasion)
(a) Public		
(b) Private	Decontrol interest rates  Restrain real wages	Real positive interest rates, compulsory saving: raise saving rate of social security system (or reduce actuarial deficit)
3. Investment (improve its allocation)	Decontrol interest rates	Develop capital markets and eliminate their segmentation by opening them up to small and medium-sized businesses through the use of leasing contracts with purchase options, factoring and the use of venture capital
4. Employment	Deregulate the labour market; restrain real wages	Tie wages, at least in part, to each company's output in order to boost productivity and stimulate employment
5. Private investment in human capital	None	Develop the capital market for private loans to finance higher education and training, using the individual's pensions fund as collateral
6. Technological development	None	Strengthen technological infrastructure, especially as regards information sciences and telecommunications; link up scientific and technological research with production sectors; promote modernization and consultancy market by co-financing a certain percentage of a firm's advisory services; undertake industrial outreach efforts
In general	Passive measures/ deregulation	Active measures/promotion

Nor is the interest rate the only criterion for resource allocation, since the region's capital market is as yet very rudimentary, especially as regards long-term funds, and access to it is highly segmented, which works to the detriment of small and medium-sized firms and militates against private investment in higher education or training. In fact, much of the investment needed for these activities is financed by the parties directly involved or is not carried out at all, regardless of how profitable it might be. To overcome these voids and segmentations, neostructuralism suggests the promotion of leasing arrangements that include a purchase option, the use of

venture capital, factoring, and the use of pension funds to secure private credit for investment in human capital.

Orthodox theory attributes unemployment primarily to labour-market rigidities; hence its insistence upon measures that facilitate lay-offs, limit unionization and impede strikes, deregulate job entry and eliminate or lower minimum wages. Certainly, union monopolies are hazardous, as are entry barriers for certain types of jobs (just think of the high cost—especially for economies, such as ours, that are trying to forge a place for themselves in world trade—of having our ports controlled by limited groups of

workers). By concentrating entirely on these types of measures, however, it overlooks rigidities of another sort, which stem from the use of conventional fixed-wage labour contracts, under which income bears no relationship to a company's performance; by using such contracts, firms sacrifice significant potential gains in productivity and force themselves to lay off workers as the only practical means of dealing with recessions. Neostructuralism, on the other hand, advocates labour contracts that provide for wage flexibility, as in Japan, the Republic of Korea and the Chinese province of Taiwan, since this not only promotes better intra-firm labour relations, but also boosts productivity and reduces unemployment.

Finally, the orthodox approach completely neglects a key factor in the development of nations: the promotion of technological progress and its dissemination. Although promotional measures in this field are not as clear-cut as we might like, their qualitative, institutional character does not make them any less important. The development of a scientific/technological infrastructure closely linked

to the production system, the promotion of technological and organizational dissemination through the selective cofinancing of consultancies and business training courses, or the creation of industrial outreach services are some of the steps that would take us in the right direction.

In sum, whereas the orthodox approach, based on an assumption of perfect markets, focuses exclusively on liberalization and deregulation, neostructuralism calls for the use of more active instruments for overcoming critical bottlenecks based on the actual capacity for action –and for effective action– of the State.<sup>9</sup>

<sup>9</sup>This list of instruments by no means constitutes a basic minimum (or maximum) policy package. It is presented only as an illustration of the types of measures that could be taken if a particular problem in a given economy were to reach critical proportions, provided that the State truly had sufficient institutional capabilities to support such measures once it had fully performed its fundamental tasks.

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# Market failure and *technological policy*

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This article highlights the need to complement macroeconomic policies designed to secure stabilization, deregulation and greater openness with other macroeconomic and microeconomic measures aimed at revitalizing the growth and competitiveness of the countries of the region. At the national level, in terms of macroeconomic measures, it is necessary to increase domestic saving and channel it towards productive investments within the local context, while microeconomic policy should include measures to develop and consolidate in the countries an innovative, wide-ranging system for furthering changes in the production patterns of the economy and promoting the transition to new technologies and forms of participation in international markets. It would also be advisable to improve management capacity, the generation and dissemination of technical knowledge, and the quality of human resources, while also encouraging a spirit of enterprise after years of macroeconomic instability and pursuit of short-term speculative rents which are generally incompatible with efforts at innovation and technological progress. At the supranational level, integration programmes like MERCOSUR or NAFTA demand a new institutional framework favouring the coordination and harmonization of public policies, including those designed to promote the training of highly-skilled human resources and technological innovation. Moreover, legislation on industrial property, quality codes and standards, standards of certification, etc., must now be reviewed in the light of the new context of industrial organization which is emerging.

# I

## From import substitution industrialization to stabilization programmes

A new breed of market-oriented theoretical ideas and policy proposals seems to be gaining ground among economists. Protectionism, excessive inward-orientation and direct investment subsidies –all of them resulting from a high degree of government intervention in the economy– are increasingly identified as the main source of poor economic performance.

The degree of government intervention in the economy increased quite considerably –both in developed and developing countries– during the 1940s and 1950s. It did so in the aftermath of the market failure debate of the 1930s, and was associated with Keynesian economics, on the one hand, and socialist planning, on the other (Helm, 1989). In most developing countries, this intervention took the form of what later came to be known as the import substitution industrialization strategy (ISI). Different sources of market failure –whether micro or macro, and whether originating on the demand side, on the supply side, or in market structure– gave rise to a clamour for intervention by the ‘visible’ hand of Government. In addition, greater expectations concerning social justice and individual rights led to the establishment of the basic principles of the Welfare State.

The abandonment of the Gold Standard made necessary the creation of Central Banks and the introduction of active monetary policy in many peripheral countries. Economies of scale –leading to industrial concentration and monopoly pricing– suggested the desirability of nationalization and public production in sectors such as steel or petroleum. The insufficiency of capital markets induced the establishment of financial institutions and development agencies. The shortcomings of the insurance market, the inadequacy of information and the unsatisfactory operation

of the system of consumer preferences made necessary social insurance and the public provision of such goods as health or education. And so on and so forth. A new set of institutions and ideas developed worldwide as a consequence of the emerging new values and principles, and the role of the State became central within the new patterns of social organization that resulted thereafter.

It is important to note that these were years of rapid economic expansion for both developed and developing countries. Within such a climate, the world economy and international trade grew significantly for quite a long period of time. Foreign direct investment in manufacturing acted as a major growth-inducing force in many peripheral societies and had a considerable impact upon the rate and direction of the industrialization process. Little consideration was then given to the high (and increasing) degree of government intervention in the economy and, in a more general way, to the fact that the public sector was gradually taking over initiatives and responsibilities which naturally belonged in the private sector.

Relatively low-cost external public financing and foreign direct investment in manufacturing supplied the resources thanks to which this model was able to spread rapidly to many Third World countries. Excess domestic demand in the early stages of the ISI process provided the basis for a period of rapid economic growth within the limits of the internal market.

This process of rapid economic growth lost momentum in the late 1970s. The international economic scene suffered a dramatic transformation after the oil shocks of 1973 and 1979 and the Mexican debt moratorium of 1982. As a result, the expansionary process in the industrialized world suffered a major setback and practically ceased to act as a growth-inducing force in the peripheral world. At the same time, a drastic slump in raw material prices, the drying-up of external finance and skyrocketing interest rates gave rise to a less friendly world environment for developing countries, which thereafter could hardly maintain the levels of development they

■ This paper is based on a commentary on the document “IDRC regional strategy for the Latin American and Caribbean Region”, Ottawa, IDRC, 1991 (mimeo). Comments by Dr. F. Chaparro on a first draft of this paper are hereby acknowledged.

had attained, so that they lost ground internationally. In addition to the above, the rapid spread of microelectronics and of flexible automated production technologies rapidly rendered obsolete much of the technological capacity acquired by the developing countries through domestic R&D efforts during the ISI process.

As a result of the foregoing, the domestic socioeconomic environment of many developing countries became increasingly unstable and fragile. Their faltering overall economic performance and the massive escalation in social repression which occurred after military coups in countries such as Argentina, Brazil, Chile, Uruguay, Bolivia, etc., point to the fact that a major transformation of the long-term development model of many peripheral societies was clearly in the making. The rate of saving and investment suffered a dramatic contraction, and the inflow of foreign investment in manufacturing became much less significant than in the immediate post-war years, or ceased altogether in many countries. The process of capital accumulation deteriorated badly and public accounts moved into huge deficits which could only be covered by printing money and imposing a rapidly rising inflationary tax.

In such critical circumstances, many peripheral societies attempted to return to orthodox free-market principles during the 1980s. They drastically curtailed the regulatory role of the State and opened up their economies to foreign competition. A new set of institutions, markets and patterns of social organization gradually began to emerge as a consequence of this, giving rise to a profound socio-economic transformation which is now steadily working its way through the socio-economic structure. This as yet unfinished transformation, whose impact on production efficiency and social equity is still far from clear, will surely have far-reaching consequences in the years to come.

Questions of production efficiency and international competitiveness, as well as major issues concerning social equity and political governance, are clearly at stake and demand a new and fresh discussion. Once again, the role of governments and markets appears to be called into question, and a new debate seems to be urgently needed concerning the massive process of 'creative destruction' many Third World countries are presently going through.

It goes without saying that the above-mentioned transformation, both as regards values and principles as well as the rate and nature of the growth process,

has strongly affected the way in which economists—and social scientists in general—are now looking at development problems. Today, on the basis of ideas emerging from strict conventional neoclassical thinking, many professional economists take a negative view of the ISI strategy and are highly critical of what they see as 'government failure' during the post-war period.

From this extreme perspective, the import substitution industrialization process has left the developing countries with distorted and inefficient production systems as a result of long-standing protectionism. Excessive inward orientation, low international competitiveness and rent-seeking behaviour on the part of local businessmen are all regarded as the result of over-intervention by governments in the economy. Such an extreme view—although widely held—is probably false, as the last Annual Report of the World Bank argues on its introductory page when it says: "This is not a question of intervention vs laissez-faire. ...Competitive markets are the best way yet found for efficiently organizing the production and distribution of goods and services. ... But markets cannot operate in a vacuum. They require a legal and regulatory framework that only governments can provide. [Moreover] ...markets sometimes prove inadequate or fail altogether." (World Bank, 1991).

Thus, and in spite of the fact that the neoclassical critique of the ISI model rightly spells out a number of major aspects in which the 'visible hand' of government has failed dramatically, we have to recognize that many 'ifs and buts' still persist and that at both the conceptual and policy level it is by no means obvious—at least not for the present author—that the advice of "get your macro prices right and let the market mechanism do the rest" is all that is needed in development economics.

There are at least three different sources of doubt concerning the simple neoclassical views on these matters.

First, even "well-behaved" cases—such as Korea or Chile, which are so frequently cited by supporters of the liberalization approach such as Krueger and Balassa (see Balassa, 1990)—have been seen in quite a different perspective by other authors. Thus, Amsden (1989) and Kim (1990) have pointed out that there was a much higher degree of government involvement in the economy than what neoclassical economists have reported in their own accounts of the facts.

Let us consider the case of Chile. The availability of external finance in the mid-1980s (even taking account of the dramatically high external debt ratio) and the public ownership of its major export commodity –copper– seem to suggest that the explanation of the Chilean economic restructuring efforts of the 1980s requires a more complex analysis than that reflected in the simple neoclassical account of the facts. Likewise, the rather peculiar relationship which the Korean State managed to establish with its large national conglomerates (the Chaebolds) seems to indicate that the Korean story, too, has its own idiosyncratic side which is not adequately accounted for by a simple neoclassical description.

Second, some skeptical Latin American voices have recently been raised, arguing that the neoclassical approach tends to ignore some problems posed by the Smithian and Keynesian tradition. Thus, it ignores the problem of how to generate more savings and how to ensure that savings are allocated to investment, because it takes the view that the market forces are potentially able to simultaneously resolve classical, Keynesian and neoclassical questions. It holds that the problem of increasing savings –the classical or Smithian question– does not exist *per se*, because a market-determined interest rate can automatically induce the optimal amount of savings, and by the same token, the problem of deciding between higher-risk and solid portfolio investments –the Keynesian question– does not arise either, because the growth models of the Arrow tradition take it for granted that investment and savings are instantly equalized by the market (Fanelli, Frenkel and Rozenwurz, 1990).

Now, it so happens that over the course of the last 15 years the rates of public saving and investment have been significantly reduced in many developing countries, while private savings have been transnationalized and are now financing the economic restructuring process of more mature industrial societies. Lack of credibility –which in some cases persists even after several years of successful stabilization efforts, as in the cases of Bolivia or Uruguay– has prevented the restoration of capital markets and of the capital accumulation process. A “bottom of the well” equilibrium situation has emerged and it is by no means obvious how to deal with this new set of circumstances. “Wait and see” seems to be the only answer the neoclassical model so far has to offer for cases of that sort.

In view of the above, Fanelli, Frenkel and Rozenwurz (1990, p. 41) underscore “the need to generate more savings and to reinforce the links between savings and investment in order to restore growth in Latin America”.

Third, while the above-mentioned sources of failure are macro in nature: i.e., they involve economy-wide disequilibrium processes, there is yet another important category of “market failure” situations which are essentially microeconomic and which the neoclassical model frequently leaves out of consideration as well. Some of them –notably those related to the existence of “public goods”, externalities, increasing returns to scale, etc.– clearly provide a strong case for State intervention and valid grounds on which to argue that the “visible hand” of the Government still has a valuable role to play in development economics.

In particular, many of these issues appear in relation to the generation, diffusion and utilization of technical knowledge and to the functioning of the national system of innovation supporting the process of technical advance in the production of goods and services. There can be little doubt as to the crucial role innovation and technological change play in the building up of international competitiveness, and it is precisely here that the role of governments in strengthening the workings of the national system of innovation, supporting the process of technical change, and promoting a greater degree of technological innovation at the enterprise level can be conceptually defended, even under strict *laissez-faire* rules. Once again, the last Annual Report of the World Bank (1991) explicitly recognizes this when it says: “Certain actions involving public goods [admit intervention] because the private sector does not usually carry them out: spending on basic education, building up infrastructure, etc.”.

We shall argue here that there are strong *a priori* grounds for believing that market signals operate only in a very imperfect manner in the field of knowledge generation and diffusion as well as in the upgrading and development of qualified human resources. Consequently, explicit government action is needed if developing countries are to generate the basic technological and human capital infrastructure required for a satisfactory process of growth, technological modernization and re-insertion into world markets. These are the topics that we shall examine in our next section.

## II

### Market failure in the generation and diffusion of technical knowledge, and the need for an explicit technological policy

We have so far argued that policy proposals involving short-term stabilization efforts, deregulation of markets, the opening up of the economy to foreign competition, etc., constitute a *sine qua non* condition for a successful process of re-insertion of the region in the world market. We have also indicated that there are strong *a priori* grounds for believing that such macropolicy actions may be a necessary but not a sufficient policy package if developing countries are to be successful in revitalizing their capacity for growth and their international competitiveness.

At the macro level, explicit policy actions might be needed in order simultaneously to deal with what Fanelli, Frenkel and Rozenwurzel (1990) have called the "Smithian" and "Keynesian" constraints on growth, that is to say, insufficient volume of domestic savings and the difficulty of ensuring that such savings are effectively channeled into productive investment activities within the local economy. The existence of these growth constraints induced those authors to argue that the agenda of public actions required in the near future probably needs to incorporate far more questions and issues than those that neoclassical authors have so far considered necessary. Stabilization with growth—which means simultaneously closing the fiscal and external gaps as well as restoring the capital accumulation process—will probably require more than just minimal actions on the part of developing country governments, as well as changes of attitude by financial institutions and international and regional organizations such as IDB, the World Bank, etc. Further deregulation and opening up of the economy to foreign competition, new forms of external financing, and a lower degree of protectionism in raw material markets on the part of developed countries, together with a more open attitude by industrialized nations concerning the diffusion of technology and intellectual property rights, etc., belong in this area. Many of these issues have been discussed in connection with the Uruguay

Round and the Brady Initiative, but we are still a long way from having achieved substantive progress on this front.

Leaving aside the macro policy debate on stabilization and growth for the time being, let us concentrate on microeconomic issues related to how to strengthen domestic technological capabilities and the functioning of the national system of innovation supporting the process of technical change in industry, agriculture, etc. In other words, let us now concentrate on the issue of how to develop and consolidate a "generic" technological infrastructure capable of supporting the modernization of the production structure of the economy and the transition to the world of flexible automation, biotechnologies, telecommunications, new materials, etc., which is gradually gaining ground in mature industrial societies.

A number of structural features prevailing in the markets for technical knowledge and information as well as in the field of education and human capital creation—such as imperfect appropriability of benefits, externalities, incomplete specification of production functions, scale economies in the generation and utilization of knowledge, etc.—suggest that institutions other than the price mechanism might be needed in this field if peripheral countries are gradually to build up the kind of "generic" technological infrastructure—and the new company attitudes towards innovation and technical change as well as towards human capital upgrading—they now need to meet the challenge of the international marketplace. The creation and strengthening of a network of institutions, agencies and policies related to the generation and diffusion of technical change, to the recycling and upgrading of human resources, to the opening up of new international markets, etc., appear to be a *sine qua non* condition for a dynamic process of technological change and modernization and for the consolidation of new patterns of insertion into

world markets for goods and services. Universities, public research agencies, producers of capital goods, trading companies, banks, Ministries of Industry and Trade and of Education, Departments of Science and Technology, etc., need to be seen as individual parts of a complex network of actors whose coherence is crucial if peripheral countries are to regain international competitiveness and capability for self-sustaining growth. In addition to the above, a new set of incentives is required in order to revitalize the willingness to take greater investment risks and reinvigorate entrepreneurial attitudes after long years of macroeconomic instability and rent-seeking behaviour.

Major changes in the domestic socioeconomic and institutional environment are required for this to take place. On the one hand, the building up of new domestic technological and managerial capabilities is an essential condition for any further improvement in productivity and international competitiveness. On the other hand, this by itself might not be enough if it is not supplemented with the right kind of economic incentives and institutions which would insure that the restructuring process is accompanied by a new export-oriented mentality capable of inducing local entrepreneurs to explore new and imaginative ways of entering into the international marketplace.

#### **1. Strengthening the domestic technological, managerial and human capital infrastructure in the countries of the region**

A first major issue related to the achievement of better international competitiveness undoubtedly has to do with the creation and upgrading of human capital and with the enhancement of the technological and managerial capabilities of the countries of the region.

##### *a) The creation and upgrading of human capital*

Notwithstanding the fact that all kinds of education seem to be needed for industrial progress, greater emphasis on science and engineering training appears to be essential for coping with fast-moving and complex new technologies such as those involved in the transition from electromechanical to electronic production processes and product designs. Microeconomic aspects related to the organization of work on the shop floor, as well as industrial organization issues at the sectoral and macro level, are involved in

this and demand urgent consideration. New types of information management, new forms of telecommunications, new patterns of industrial relations, etc., are at stake here, and in all of these spheres managers, engineers and technicians, as well as plant workers, need to learn new skills and patterns of interaction.

It is important to determine the level of secondary and tertiary education enrolment ratios, but such aspects as the technical orientation of students, the length of training, the quality of teaching, etc., are also major aspects educational authorities should look into. These are all topics about which we still know very little and which demand urgent new research if public policies are to proceed on a strong footing on this front. The Korean and Taiwanese experience in this territory is quite remarkable, and many economists have in recent years suggested that their policies in this respect are the main explanatory factor of their successful economic performance of the last two decades (Lall, 1990). Urgent domestic action—and international collaboration—in the building up of a “generic” human capital infrastructure is clearly a first priority on the present agenda of public action. Complementary to such public policy efforts, intra-firm training programmes are also required in order to facilitate:

i) *Upgrading of human resources and the transition from electromechanical to electronic skills and techniques.* This involves the recycling of engineers, machine-tool operators, etc. already in the labour force, as well as a complete rethinking of the curricula new generations of technicians, workers and engineers study at universities, secondary, vocational and technical schools. In this respect, the curricula in such areas as mathematics, trigonometry, computer sciences, etc., need to be strengthened and modernized. “Custom-made” product design, flexible manufacturing production organization techniques, universal standards and norms, etc., are some of the crucial aspects with which new generations of engineers and technicians will have to be familiarized in their training. Much of this is in the nature of a “public good”, where public expenditure is fully justified in view of its high expected social rate of return.

ii) *The recycling of industrial management.* Strategic planning, “Kan Ban”, “just in time” and “total quality” production organization techniques, as well as greater use of indirect methods in the

production process, new forms of global sourcing, etc., are among the new skills modern industrial management has to handle in a marketplace which is rapidly evolving towards "custom-made" products and world-wide production systems (Kliksberg, 1991). Decentralization of production and global sourcing are some of the new conceptual tools the oncoming generation of managers will have to learn to use in the present circumstances.

The dramatic transition many big transnational firms (such as Ford, Fiat or Olivetti) had to go through in recent years in order to regain international competitiveness, and the huge price –both in terms of personnel turnover and management restructuring– which all of these firms had to pay in order to master newly emerging electronics-based production planning and organization techniques show that this is by no means a marginal issue. A network of public and private institutions needs to be created to facilitate this transition, along with experimental research "trying out" different approaches to see what works, and how, as well as joint efforts between the public and private sectors.

iii) *Flexible automation and trade union participation at the shop-floor level.* The successful adoption at the shop-floor level of many of the new production organization techniques, such as "just in time" or "total quality" arrangements, requires institutionalized procedures for trade union participation in production decisions, as well as a completely new approach to "on the job" training. It also demands a major transformation in trade union attitudes to plant operation and the flexibilization of labour contracts. Much of this is already happening at the enterprise level (Middlebrook, 1991), but we still do not fully understand many of the new micro/macro issues this involves. As in the previous cases, more research on these topics seems to be urgently needed.

The need for a massive effort on the educational front and in the building up of human resources comes at a time when public social expenditure has contracted quite drastically in most developing countries as a result of structural adjustment programmes whose main priority is to reduce –or completely eliminate– the public sector deficit regardless of the long-term impact such a policy option is going to have upon the social sectors of the economy (health, education, etc.) and its likely negative consequences for the sources of economic growth.

According to recent World Bank statistics (World Bank, 1991) a large number of Latin American countries registered a decline in government expenditure on health and education, as a percentage of GDP, between 1980 and 1985. The impact these policies are going to have upon total factor productivity growth and international competitiveness in the years to come has not yet been seriously examined, but there are strong grounds for believing that it is going to be far from negligible.

The importance of foreign collaboration in all of the above-mentioned areas must be stressed. Expatriates who are now permanently established in the academic and professional communities of more mature industrial societies, as well as retired professionals and educational agencies of developed nations could be called upon in order to assist developing countries in the massive educational and training effort they now require if they are to meet the challenge of the international marketplace.

The development of human capital along the lines suggested above is a necessary but not sufficient condition for the gradual revitalization of international competitiveness. Additional measures aimed at strengthening firm-specific administrative and technological capabilities and country-wide export orientation and international market penetration are needed as well, and these will be examined later on in this paper when dealing with the creation of new institutions and incentives. Government intervention is fully justified in this field in view of the fact that the "generic" industrial organization infrastructure required for this is in the nature of a public good.

In many of these aspects we do not know for certain the best way to proceed, and experimental research to explore what works and what does not work would be highly valuable for further public policy design and implementation. In spite of the acknowledged long history of "government failure" during the substitutive industrialization process, imaginative new ways of intervention will have to be explored on this front, in view of the highly imperfect behaviour of markets when "public goods" are involved.

b) *The generation and diffusion of new technical knowledge and information.*

Close to the previously discussed topic of how to create and upgrade the human capital infrastructure of peripheral nations we find a set of issues

concerned with the size and quality of the already available R&D infrastructure. Let us now briefly examine some of the questions hereby involved.

i) *R&D efforts*. Imperfect appropriability of results, increasing returns to the generation and utilization of scientific and technical knowledge, etc., indicate that we can expect markets to behave in an imperfect manner in relation to the allocation of resources to R&D activities. Public sector spending on R&D can therefore be justified even under strict *laissez-faire* rules. Furthermore, many of the public sector requirements in areas such as transport facilities (including roads, port and shipping infrastructure, etc.), telecommunications, energy, health, etc., demand "made to order" equipment and technologies which cannot easily be obtained "off the shelf" in the international market. "Tailor-made" solutions demand a great many highly idiosyncratic knowledge-generation efforts which must be performed locally.

The case for public support of R&D activities and risk-sharing and subcontracting with the private sector in the above-mentioned fields seems therefore particularly strong. The experience of mature industrial societies in this respect is highly illuminating, if we are to judge by the role played by NASA, the Departments of Agriculture, Health, Defense, etc., in the US, or by the Ministry of Industry and Trade in the UK and MITI in Japan, to name just a few examples.

Having said the above, it is important to understand that many Latin American developing countries currently spend somewhere in the region of 0.5% to 0.7% of GDP on R&D activities. Around two-thirds of such expenditure is absorbed by research and development efforts carried out by public laboratories, universities, etc. However, there is a great deal of institutional slack, inadequate selection of research priorities, lack of *ex post* peer evaluation of the amount and results of such expenditure, etc. in this field. A major "institutional engineering" effort needs to be undertaken in this area before further resources are spent on domestic R&D activities, but there is nevertheless no doubt that the domestic effort on the R&D front needs to be significantly expanded if these countries are to meet the challenge of creating the new social and technological infrastructure they require. Only after a serious effort is made to reorganize and improve the cost efficiency of the existing R&D network and infrastructure should resources be significantly increased on this front.

ii) *Diffusion of technology*. There can be no doubt that, from the point of view of total factor productivity growth and international competitiveness, the technological upgrading of small and medium-sized enterprises is a major issue requiring consideration. Many small and medium-sized family firms are considered to be lagging well behind prevailing average technological practices, and bringing them gradually up to scratch as far as production planning and organization, product design capabilities, etc. are concerned should be given high priority within the national agenda. Here, too, a fair amount of "institutional engineering" and government intervention seems unavoidable, given the "public good" nature of the generic technological assets involved.

Recent policy actions by the British Ministry of Industry and Trade on what we could call "industrial extensionism" indicate the general direction of the policy prescription we have in mind in this case: a widely circulated paper from the above-mentioned Ministry tells British small and medium-sized firms that "...The (Ministry's) Advisory Service will undertake a feasibility study lasting up to 15 man-days with the cost split equally between you –the firm– and them. Alternatively, 50% support is also available from DOI (Department of Industry) if you employ an independent authorized consultant." It goes on to mention that "...Another very valuable source of information and advice is the British Robot Association. It will put you in touch with manufacturers experienced in your type of application, suggest further reading materials, etc." (United Kingdom Ministry of Industry and Trade, Department of Industry, 1982).

The foregoing provides a clear example of how a central government agency can explicitly intervene in favour of a faster process of technological diffusion and productivity improvement, particularly among small and medium-sized enterprises which may be operating with imperfect information about alternative opportunities and possible courses of action. This particular type of intervention must be seen as part of a broader set of institutional interactions loosely defining what we consider a "generic" technological policy should be. Obviously, both public and private agencies have important roles to play in networks of this sort.

We have so far examined public action related both to the creation and upgrading of human capital and the generation and diffusion of new technical

knowledge and information. Such action may be important for the enhancement of international competitiveness, but it may not be sufficient under present circumstances. In our next section we shall examine

various additional incentives and institutions which might be required in order to support the new export orientation now needed on the part of the domestic entrepreneurial community.

### III

## Institutional engineering efforts

Many of the above-mentioned spheres of public policy action clearly demand institutions—both public and private—capable of interacting in new and creative ways. It would be wrong to expect that the “invisible hand” of the market will, of itself, induce the establishment and strengthening of the kind of institutional networks needed for this. Exploratory programmes between public and private agencies—business associations, groups of firms, universities, public R&D laboratories, etc.—have to be set in motion to try to develop the kind of scientific and technological infrastructure most developing countries now require in order to attain a faster process of modernization as well as a less painful transition to electronics-based technologies, new telecommunications systems, etc.

It is important to understand that it is the “public good” nature of the technological assets involved in this that calls for collective action and exploitation of the “generic” part of such assets. Contemporary authors see such collaborative efforts as pre-competitive research and point to the “common pool” aspect of the social organization model underlying their functioning (Stiglitz, 1987). Price signals seem to be particularly inefficient in situations of this sort, and it is precisely this feature that calls for public intervention.

It should be noted, however, that action of this sort on educational and technological matters, important though it may be, may not be enough for a successful revitalization of international competitiveness under present circumstances. Given the low state of “animal spirits” that the domestic business community presently exhibits in many developing countries and the indiscriminate effort most of these countries are nowadays making with regard to the deregulation of markets and the opening-up of the economy to foreign competition, more action may be needed on the part of the public sector if the present

period of transition towards decentralized market functioning is going to bring the expected positive social returns, rather than wreaking havoc in the existing production structure. It seems reasonable to argue that external collaboration from developed countries and new institutions and mechanisms of interaction between public and private agents may be needed during this transition to a much less regulated model of production organization. These institutions should focus on such aspects as the deterioration of equity, anti-dumping legislation to deal with unfair competition, etc.

Let us now consider these topics in some detail. A broad set of issues—some apparently of only minor importance, such as organizing the right kind of consular and marketing information services in support of domestic exporting companies, others as major and fundamental as having adequate port and shipping facilities—might be listed in the agenda of possible public actions to be carried out with the purpose of enhancing international competitiveness. As in the case of education and the generation and diffusion of technology, there are many “public goods” involved here, and it is precisely this fact that justifies explicit government intervention on this front.

Aspects connected with equity—and their relationship with productivity growth, on the one hand, and with issues of political governance, on the other—come next in the list of topics demanding urgent consideration and explicit government action. A falling rate of public social expenditure in areas such as health or education might prove to be highly detrimental in the years to come from the point of view of production organization, quality standards and, ultimately, international competitiveness. On the other hand, a higher unemployment rate and the transfer of human resources to the informal sector of the economy, as well as the deterioration of the average

health standards of the population –aspects which might well result from the ongoing industrial restructuring process– might bring into question an otherwise highly necessary structural adjustment process and generate a feeling that the government's attitude is not legitimate. Unemployment subsidies and institutions capable of mitigating the hardships of the transitional period as far as health, social security, etc. are concerned might be justified in order to raise confidence in the expected benefits of the structural adjustment efforts, as well as to avoid extreme forms of social conflict and exclusion.

Finally, a few remarks are called for on anti-dumping protection. Given the very uncritical way in which the opening up of the economy to foreign competition is now taking place, it seems reasonable to utter a word of warning. It is worth remembering that the most successful newly industrialized Asian countries did not massively ex-

pose their manufacturing firms to foreign competition during the early stages of their development process. That is certainly the most widespread interpretation of the Korean and Taiwanese experience. It is no doubt true that the “infant industry” argument has been grossly overplayed in many peripheral countries during the import substitution industrialization period and that this has made both economists and ordinary citizens highly critical of protectionism and inward orientation. It is also true, however, that learning takes time and money and that the danger of dumping activities by foreign suppliers should not be minimized. Indiscriminate opening up of the economy to the impact of foreign restrictive practices might lead to the failure of the whole industrial restructuring effort. Antimonopoly and anti-dumping legislation and careful customs rules and procedures should be part and parcel of the present institutional restructuring efforts.

## IV

### National and supranational levels of intervention

There are strong indications that the world economy is now gradually entering a stage of transnationalization and globalization, particularly in so far as production and trade are concerned. National development strategies –though still only mildly influenced by these trends– will eventually come to incorporate in a more explicit way the opportunities and restrictions resulting from the process of regional and subregional integration now under way.

Integration programmes such as those of MERCOSUR, the Board of the Cartagena Agreement (JUNAC), the North American Free Trade Agreement (between the United States, Canada and Mexico), etc., are examples of this process of globalization. National frontiers are bound to lose some of their traditional significance in the years to come, and institutions of supranational level will gradually have an increasing impact on the behaviour of the local economic agents.

The impact of the globalization process needs to be analysed both at the micro level (in relation to new types of business strategies) as well as at the

macro level (in connection with national development strategies). Neither of these spheres has been fully explored so far, and major research efforts will be called for in the future.

At the macro level, integration programmes such as MERCOSUR, for example, involve the establishment of a common external tariff and common trade policy with respect to third countries or groups of countries, as well as the coordination and harmonization of macroeconomic, fiscal, monetary, exchange, agricultural and industrial policies. The task of coordination and harmonization is by no means an easy one, as the experience of the EEC clearly shows. Specific research and technical information concerning each one of the above-mentioned fields is required, and technical groups to explore the new issues have to be put together before any serious progress can be made in the negotiation itself. This is precisely where both Argentina and Brazil are presently standing as far as their future participation in MERCOSUR is concerned.

An example of this is the discussion between the MERCOSUR countries in relation to the establishment of a common external tariff and tariff structure.

In spite of the fact that both the average and the inter-industry spreads of import duties have fallen in the above-mentioned countries during the course of the last decade, it is nevertheless true that significant differences still persist and will have to be ironed out before MERCOSUR actually comes into operation in 1994. Argentina operates with an average external tariff of 12.7%, while Brazil, Paraguay and Uruguay currently exhibit average external tariffs of 28%, 16% and 23.7%, respectively (*Conexión*, 1991). Representatives of these four countries are presently working on the design of a common external tariff structure, but differences in their industrial structure and productivity levels and the paucity of the available information make this task very difficult. The macroeconomic coordination and harmonization required for the integration process is far from easy and will demand a great deal of economic research, political will and an institutional learning process in the years ahead. A number of new institutions of supranational level will have to be designed and put into operation, and a "learning by doing" process is likely to take place *pari passu* with the economic integration itself.

The supranational institutional efforts needed in relation to the training and upgrading of human resources are of a different nature. The common perception of the fragility of the existing human capital in such areas as informatics or biotechnology has in recent years induced Argentina and Brazil to tackle the question of human capital development jointly, through the creation of the Latin American

School of Informatics and the Argentine-Brazilian Biotechnology Centre (CABBIO), both within the framework of MERCOSUR. In spite of the fact that both these experiences are recent and rather small in terms of expenditure, they seem to be pointing towards the type of collaborative efforts that could be explored in the future in the field of human capital upgrading.

Finally, we also need to consider microeconomic aspects related to changes in individual firm behaviour triggered off by regional integration processes. Technical cooperation agreements between companies—along the lines of those that have flourished in the Pacific region, between United States, Japanese, Korean and other enterprises—will probably emerge in due course in other regional groupings such as MERCOSUR or the Free Trade Area between Canada, the United States and Mexico.

The question of intellectual property rights and the strengthening of the patents system is a major issue in this field and one in which a great deal of institutional change is presently taking place under the pressure of the United States Government. Countries as different as Spain, Greece, Mexico or Argentina are currently introducing more stringent patents legislation than that which they had during the substitutive industrialization period, in the expectation that such policy action will greatly improve their institutional credibility and the inflow of foreign manufacturing investment and its associated technological component. It goes without saying that the evidence in support of such expectation is rather thin, but this is undoubtedly an area in which more research will be needed in the years ahead.

(Original: English)

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# The monetary crisis, *dollarization* and the exchange rate

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The purpose of this paper is to contribute to the debate on stabilization policies in conditions of high inflation in the light of the experience of Brazil and some other countries, especially the European monetary crises of the 1920s and the stabilization of the Argentine currency in 1991/1992. The paper begins with some comments on certain special features of situations of high inflation, with emphasis on the unfeasibility of following the sequence of measures recommended for dealing with only moderate imbalances. It goes on to criticise some aspects of the economic policy adopted in Brazil in 1991/1992, demonstrating this policy's inability to break out of a vicious circle in which monetary instability and fiscal imbalances mutually aggravate each other. It is asserted that in certain circumstances stabilization can lead to regression to a more primitive type of monetary system, namely the abandonment of pure fiat money based exclusively on authorization and sanction by the State. The anti-inflation policy applied in Argentina since April 1991 is analysed, and its strong points and some of its problems are highlighted; this Argentine programme is described as a regression to a monetary model rather like the old Gold Standard, in which the dollar occupies the place of a "sacred relic". Finally, the consequences of the very marked revaluation of the Argentine currency are analysed, and some characteristics of economic cycles typical of exchange-rate-based stabilization programmes are examined, together with the difficulties standing in the way of the application in Brazil of a programme like that of Argentina.

# I

## Monetary crisis and stabilization

*"Trying to balance the Budget in the midst of monetary instability is like trying to play billiards on a storm-tossed ship"*

Lloyd George<sup>1</sup>

The failure of the wide range of attempts made to combat inflation in Brazil over the last ten years has ended up by generating widespread discouragement and skepticism which make it more difficult to discuss the problem and the measures needed to solve it. The growing violence of the anti-inflationary measures imposed by administrative decree or provisional measures, which reached its height with the 1990 monetary reform, gave rise to the understandable rejection of fresh experiments in the monetary field.<sup>2</sup> It also ended up, however, by paralyzing economic policy itself, which was limited during the period of office of Marcílio Marques Moreira to merely pretending to combat inflation, the only achievements being to put off the outbreak of open hyperinflation or to repress it with measures of a recessionary nature.

This paralysis of economic policy was due in part to the political decadence of the Collor administration, which lost the authority needed for the

successful implementation of a programme to achieve stabilization and renewed development. Over-concentration on this aspect of the Brazilian situation, however, may cause us to lose sight of the real essence of the problem, which lies in the profound crisis of confidence in the public authorities.

In this respect, the Brazilian case is no different from the other cases of hyperinflation. A common feature in all these cases is the breakdown of confidence in the State-guaranteed currency and the consequent trend towards disintegration of the country's monetary and financial system. When this stage has been reached, stabilization processes take on different characteristics from those observed in situations of more moderate inflation.

In these circumstances, for example, it is not feasible to repeat the normal sequence of measures recommended for situations of less serious imbalance, as is shown by past experience. Above all, it is not possible to take fiscal reform as the starting point of the financial reconstruction process. It was with this in mind that the British Prime Minister Lloyd George compared the fiscal adjustment in Germany in the early 1920s to trying to play billiards on a storm-tossed ship. In conditions of hyperinflation, there is no way of making stabilization subject to prior elimination of the public deficit or promoting lasting reorganization of the fiscal system.

This aspect of the problem did not go unnoticed by the leading economists of the period between the wars, which was marked by the enormous imbalances due to World War I and the reparations demanded from the losers. Keynes, for example, asserted at the end of 1922, likewise with respect to the hyperinflation in Germany, that stabilization of the Mark must *precede* the attainment of fiscal balance, thereby correctly anticipating the sequence observed in the

■ This article is based on a longer work completed in December 1992 as part of the research programme of the Macroeconomic Analysis Centre (CEMA) of the Foundation for Administrative Development (FUNDAP). The author wishes to express his thanks for the financial support received from the Getúlio Vargas Foundation, São Paulo, and the comments made by Carvalho, Bresser Pereira, N. Batista, Messenberg and Ramalho. He also wishes to express thanks for the assistance provided by Alençar and Scaifo, of the Consulate-General of Brazil in Berlin, and Richter, of the Latin American Institute of Economic and Social Development (ILDES) in Rio de Janeiro, in locating some of the texts on German hyperinflation in 1922/1923. De Luca helped in revision of the text and preparation of the bibliography, as did Barelli and Lima in collecting and preparing the statistics.

<sup>1</sup> Quoted by Helfferich, 1931, p. 7.

<sup>2</sup> Ex-Minister Simonsen even went so far as to write that "the best thing the Government can do as far as inflation is concerned is to refrain from trying out any new ideas": a statement which faithfully reflects the general feeling in 1991-1992 (Simonsen, 1991, p. 68).

stabilization process begun a year later.<sup>3</sup> “If the German Government waits until it balances the Budget” –he said– “it will have to wait forever, unless it previously tries to set about stabilization” (Keynes, 1981a, p. 26).

Schumpeter held similar views on the hyperinflation registered in his native land in that same period. According to him, one of the central principles of the Austrian stabilization effort in 1922/1923 was the decision not to put off stabilization until the budget could be balanced, but instead to start right away on the assumption that this would take care of “putting things in their true proportion once again” (Schumpeter, 1925, pp. 226-227). In other words, stabilization itself served to facilitate the fiscal adjustment, partly because it restored the visibility and transparency of the budgetary and tax-collection process.<sup>4</sup>

In the present context of the Brazilian economy, beginning the stabilization process with wide-ranging fiscal reforms, as intended by the Collor administration and recommended by the International Monetary

Fund, would not have been feasible even if the worsening of the political crisis in 1992 had not drastically reduced the Executive’s room for action and completely blocked the most ambitious reform projects.

It is quite true that consolidating a stabilization process depends essentially on the possibility of providing lasting guarantees of the non-inflationary financing of public expenditure. It is also true, however, that the Brazilian fiscal structure requires thoroughgoing reorganization.

Thus, anyone who imagines that structural fiscal reforms can be carried out in the midst of the uncertainty associated with 25% monthly inflation is only deceiving himself. The same is true of anyone who believes it is possible to get more tax revenue from an economy weakened by several years of stagnation or recession. The insistence of the Collor administration on following courses which would only have been appropriate in situations closer to normality merely delayed still further the stabilization of the cruzeiro and the recovery of the Brazilian economy.

## II

### Fiscal adjustment and restoration of confidence

*The Budget can never be balanced through measures that reduce national income.*

John Maynard Keynes<sup>5</sup>

The theory that without fiscal adjustment there can be no question of controlling inflation or restoring growth has once again become an article of faith. There are some grounds for this conviction. It is not possible to guarantee sustainable stabilization, which is an essential pre-requisite for restoring

development, without making lasting corrections in the financial imbalances of the public sector.

On the other hand, the recent experience of Brazil and other countries should have already taught us that, in conditions of open or repressed hyperinflation, fiscal adjustment also presupposes the

<sup>3</sup> It only proved possible to organize an effective anti-inflation programme when the German Government gave up insisting on making the initiation of the stabilization programme conditional upon the achievement of balanced public accounts. Up to September/October 1923, the prevailing conviction in the Government was that recovery of the currency was dependent on prior adjustment of the budget (Beusch, 1928, pp. 24-27). The stabilization programme was finally begun in the midst of a tremendous fiscal imbalance: in October 1923 –the month before the initiation of the programme– the income of the *Reich* covered less than 2% of its total expenditure! (Helffferich, 1924, p. 60).

<sup>4</sup> The same sort of thing occurred in Argentina in 1991, when the stabilization process was begun despite a marked imbalance in the Federal Government accounts. In the first quarter of the year, immediately before the entry into effect of the Act on convertibility, the monthly income of the Treasury covered only a little over half its expenditure (ECLAC, 1992b, table 24). The improvement in the fiscal position took place *after* stabilization, and may be attributed partly to the latter’s effects on public revenue. See for example ECLAC, 1992a, pp. 66, 68 and 69.

<sup>5</sup> Keynes, 1982, p. 149.

stabilization of the currency and the reactivation of the economy. This is not only –or even mainly– because of the erosion of public income by inflation (the “Olivera-Tanzi effect”), because this effect can be largely neutralized by arrangements for the daily indexing of taxes. The truth is that high inflation undermines fiscal adjustment in a number of other ways.

Thus, for example, it creates a suitable environment for tax evasion, in so far as it makes the control and follow-up of the tax bases more difficult. It also affects the financial component of the public deficit through the high costs of the implicit and explicit monetary correction of the government debt. The existence of significant short-term debt, indexed or at fixed interest rates, makes the gross financing needs of the State highly sensitive to the rate of inflation, since a rise in the latter will cause an increase in the financial expenditure of the government, not only in absolute terms but also as a proportion of tax income. In these circumstances, a financial crisis can arise even when the public sector has a small operating deficit and a significant primary surplus, if some unfavourable event causes a marked decline in the real demand for public debt paper.

Furthermore, a state of latent hyperinflation causes the Central Bank to maintain exceptionally high real interest rates in its desire to prevent a sudden surge in inflation. This policy may work for a time, but only at the cost of growing pressures on the government’s financial position.

In Brazil, high interest rates have a particularly strong effect on industries producing for the domestic market, which are precisely those that make the biggest contribution to maintaining the country’s tax revenue. The final result is a reduction in public revenue at all levels, with consequent prejudice not only to the Federal Treasury but also to States and municipalities, the social security system, and the operating revenue of public enterprises. It should be noted that the reduction in public income tends to be disproportionately greater than the decline in the level of activity because, in their struggle to survive, firms and taxpayers in general react to the recession with tax evasion, the adoption of more informal ways of working and, more recently, with a growing movement of judicial resistance to the payment of taxes.

With regard to the financial aspect, high real interest rates steadily increased the burden of domestic indebtedness in cruzeiros, which grew rapidly between

November 1991 and August 1992. This growth was the result of the freeing of the deposits which had been frozen by the Collor administration since March 1990, and, above all, the effort to sterilize the monetary impact of foreign exchange operations, due partly to the attractiveness of the interest rates offered on investments in cruzeiros.

During the Collor administration, the Ministry of the Economy reacted to these pressures by indiscriminately reducing non-financial expenditures and redoubling the efforts to control the cash flow, with negative effects on the operation of the Federal machinery and a recessionary impact on the economy in general. If this policy were extended, it could even send the country into a kind of recessionary tailspin: the decline in income due to the recession would lead to cuts in expenditure which would further reduce the level of economic activity, thereby generating a further drop in income, and this process would be repeated in succession, as occurred in a number of economies during the Great Depression of the 1930s. It was not without reason that ex-Minister Marcílio was compared to Heinrich Brüning, one of the German Prime Ministers of the early 1930s who, through his slavish adherence to the doctrine of balanced budgets, helped to hasten the fall of the Weimar Republic.

In short, although it is true that stabilization and development depend on fiscal adjustment, it is also true that the latter can hardly be attained in a situation marked by high inflation and declining levels of activity.

The question arises, then: how is it possible to escape from this vicious circle in which monetary instability and fiscal imbalance mutually aggravate each other? The only solution is to divide the process of financial reconstruction into two main stages, beginning with a period of temporary stabilization –a kind of breathing space– which permits some reactivation of the economy, followed by measures to lay the foundations for a more permanent adjustment of the public finances and of the economic system in general.

The need to break out of this type of vicious circle is a recurrent feature in the history of monetary crises. In the time of the Weimar Republic, for example, in the early 1920s, Germany faced similar difficulties. Late in 1922, the German Prime Minister Joseph Wirth said that there were two schools of

thought in the country on how to deal with the hyperinflation of the Mark. Some felt that any attempt at stabilization would be premature and could not achieve lasting success until the public budget was balanced. Unfortunately, noted Wirth, fulfilling this condition depended largely on stabilization itself. This gave rise to the opposing view (shared, it may be noted, by leading foreign experts such as Keynes and Cassel), according to which it was necessary to make an immediate effort to interrupt the depreciation of the Mark, even if such stabilization were only temporary.<sup>6</sup>

In conditions of high inflation, the financial reconstruction process must begin with the *recovery of confidence in the currency*, which means beginning with the redefinition or reordering of the monetary system. This often takes the form of the application of temporary monetary arrangements—that is to say, of a transitional monetary system—generally accompanied by similarly temporary measures in the fiscal and tax fields. It is this temporary arrangement which makes possible the subsequent adoption of more lasting adjustment measures in the fiscal and other fields.

### III

## Regression to a more primitive monetary system

*In the absence of other safeguards, non-convertibility is a constant temptation to commit abuses, and this fact alone is enough to cause mistrust among businessmen and discourage long-term contracts and ventures. Non-convertible currency almost always turns out to be a curse for the country that uses it.*

Irving Fisher<sup>7</sup>

In previous sections I tried to show that it is not possible to combat inflation of the type affecting Brazil with the methods normally used to deal with moderate inflation, nor is it possible to follow the conventional fiscal reform sequence—first, reversal of expectations, followed by stabilization—recommended for situations of less severe imbalance.

I also asserted that the financial reconstruction process must begin with the recovery of confidence in the currency, which means starting with the application of a transitional monetary system capable of opening up the way for more permanent measures in the fiscal and other fields.

The idea that stabilization should follow this sequence rather than the conventional one is fully

germane to the Brazilian monetary debate of the past decade and can even help to explain some aspects of the 1986 and 1990 monetary reforms. As we have already seen, it is also very pertinent to the economic debate in Europe of the 1920s, when it was frequently perceived that solving the monetary crises called for an initial *de facto* or provisional stabilization process, during which the necessary measures for solving the State's financing problems would be taken, thus preparing the ground for *de jure* or definitive stabilization (Ramalho, 1992, p. 335).

However, the need to abandon or invert the conventional sequence is not the only item worth mentioning. The most paradoxical aspect is that in certain circumstances the recovery of confidence may cause *temporary regression to a more primitive monetary system*, that is to say, the abandonment for a time of non-convertible fiat money in favour of linkage to some type of guarantee concerning money issue or to a monetary standard which is considered to be stable.

<sup>6</sup> *Gutachten der internationalen Finanzsachverständigen über die Stabilisierung*, Berlin, November 1922, pp. 5 and 13-16.

<sup>7</sup> Fisher, 1985, p. 131.

This is the essential, but not always recognized, aspect of the recent experience of Argentina, which has been trying since April 1991 to restore confidence in the national currency by pegging it rigidly to the dollar. Contrary to what is often believed, the Argentine programme is not just another stabilization effort based on anchoring of the exchange rate, but involves the fixing by *Act of Congress* of an exchange rate ceiling, full convertibility, and the legal obligation to maintain primary liquidity in Argentine currency subject to the international reserves of the Central Bank. It also involves the establishment of a dual-currency system which permits the circulation of the foreign currency in question in the economy and the signing of contracts expressed and payable in dollars.

In essence, the Argentine convertibility Act represents a return to a monetary system very similar to the old Gold Standard. It was the acute crisis of confidence in the national currency which caused the government to take the decision to anchor the currency through a guarantee that money issue would be restricted to the equivalent of the country's international liquidity, with uncertain and not yet fully explored consequences for the functioning of the Argentine economy. In order to permit this linkage to the dollar to serve as a fundamental element of the stabilization policy, Argentina had to pay the price of making the national currency subject to the fluctuations of the guarantee currency.

In modern forms of monetary organization, the "guarantee" for the national currency is provided by the existence of generalized confidence in the public bodies which have the monopoly of primary currency issue. This means that the basis of the system lies in the economic agents' perception that the general economic situation and the monetary and fiscal institutions are sufficiently sound, at least in times of peace, to guarantee constant purchasing power of the national currency, without these stable expectations depending on a linkage to a particular commodity or metallic standard. Today, currencies are non-convertible fiat money, in the pure state, exclusively on the basis of their authorization and sanctioning by the government.

In these circumstances, defence of the monetary standard depends fundamentally on the expectation that control over the public finances and money creation exists and will continue to exist in the future. Once this condition has been assured, currency stability does not require any special security and a guarantee becomes dispensable or redundant.

As it prevails in almost all the economies of the planet and in all the main countries, this essential feature of the modern monetary system is now considered entirely natural, and there is no awareness that the present model is a very special case, of quite recent origin. The truth is that the modern system only became the general rule in the 1930s, and the last vestiges of the Gold Standard survived until 1971, when the United States Government unilaterally broke the formal link between the dollar and gold.

As Milton Friedman noted in his latest book on monetary matters, in previous centuries and for a good part of the present one, the main currencies were directly or indirectly linked to one or more commodities, usually gold and/or some other precious metal. Under the logic of the system of commodity-based or metal-based money, the linking of legal currency to a particular commodity served the purpose of restricting the nominal expansion of the means of payment (Friedman, 1992, pp. 15, 16 and 42).

To use a metaphor which is in vogue today, this linkage to a metal standard constituted an "anchor" for general price levels. It was only abandoned in times of crisis, generally during prolonged wars, and this was usually followed by periods of inflation, as occurred, for example, in the case of the *assignats* and military payment vouchers during the French Revolution and the paper money issued in the United States during the War of Independence and the Civil War.

A succession of unfavourable experiences gave fiat money a bad name and led such a great economist as Irving Fisher to write, in 1911, that non-convertible paper money was "almost always a curse" for the countries using it. The unequivocal lesson of history, he asserted, was that non-convertibility led to manipulation of the currency, instability, speculation and all the resultant evils (Fisher, 1985, p. 252). This view, which was the orthodox one at that time, was only seriously weakened with the monetary upsets caused by World War I and the failure of the attempt to revive the Gold Standard between the wars.

As long as metal-guaranteed monetary systems prevailed, extreme levels of inflation were rare. This is why hyperinflation, as defined by Phillip Cagan, is a phenomenon found only in the twentieth century. It was only the invention and extensive spread of paper money and bank money that made technically possible the unlimited expansion of the nominal money supply at insignificant cost, thus permitting or allowing the extraordinary inflation rates of modern times.

However, it is precisely the abuse by governments of the freedom offered by the absence of the limitations typical of the old monetary instruments that may, in extreme cases, force a return to a system in which the government accepts or auto-imposes a kind of strait-jacket, as the only expedient capable of restoring confidence in the national currency. In terms of monetary history, this represents a regression to a previous stage of evolution, made necessary by the degeneration of fiat money.

Does it not seem that there is a parallel here with what often happens in the evolution of species?

Biology offers innumerable examples of regression to earlier stages of evolution or ancestral forms: a process known as atavism.<sup>8</sup> According to Darwin, these regressions show that genetic systems are full of hidden characteristics which may be separated from the present by many generations but which are ready to show themselves whenever the organism is subjected to certain conditions.<sup>9</sup> It is as though the development models of the past still persist in a latent form, conditioning future evolution and representing a potential reserve for rapid morphological change (Gould, 1983, pp. 180-186).

## IV

### Dollarization as a return to the Gold Standard

*"Of all the tenets of this [liberal] creed, the Gold Standard was the last to fall into disuse. .... Past experience of depreciated currencies had given the Gold Standard a prestige which was for some time beyond question; "automatic" gold currency came to be the symbol of sound practices and the emblem of honour and respectability ..."*

Joseph A. Schumpeter<sup>10</sup>

In a previous paper, I noted the extraordinary similarity between the Argentine stabilization programme, begun by Domingo Cavallo in April 1991, and the measures which Keynes recommended in order to put an end to the German hyperinflation in the early 1920s (Batista Jr., 1992, pp. 234, 235 and 237-244). When consulted by the German Government late in 1922, Keynes and other foreign specialists (including the Swedish expert Gustav Cassel) suggested that Germany should immediately return to the Gold Standard and decree a fixed exchange rate with full convertibility.

In reality, this similarity is not so surprising as it might seem at first sight, since the Cavallo plan is merely a return to what were considered orthodox monetary practices in the 1920s, when progressive economists were still struggling to free themselves from the rules of the Gold Standard. Moreover, in 1922 Keynes was still the more "orthodox" thinker of the *Tract on Monetary Reform* and was still engaged in what he was to call later (in the Preface to the *General Theory*) his "long struggle to get away from traditional forms of thinking and expression".<sup>11</sup>

The strength of the Argentine solution (which represents, as we have seen, a return to the rules of the old Gold Standard) lies above all in its recognition that, in conditions of hyperinflation, stabilization must begin with reorganization of the monetary system. By making possible a sharp and immediate reduction in inflation and interest rates and restoring credit flows, this type of programme allows the levels

<sup>8</sup> Darwin, 1921, pp. 1, 368 and 369. See also Darwin, 1985, pp. 195-202.

<sup>9</sup> Darwin, 1921, pp. 35-36. "Certain characters, capacities and instincts may lie latent in an individual, and even a succession of individuals, without our being able to detect the least sign of their presence. .... In every living creature we may feel assured that a host of long-lost characters lie ready to be evolved under proper conditions". Darwin, 1921, pp. 29 and 369.

<sup>10</sup> Schumpeter, 1976, p. 770 (first edition: 1954).

<sup>11</sup> Keynes, 1973, p. xiii. According to one of his most celebrated disciples, when he wrote the *Tract* Keynes was still a "fanatical believer" in the quantitative theory of money (Kahn, 1984, p. 53). It is no mere coincidence that Milton Friedman considers the *Tract* to be Keynes's best work. See Blaug, 1990, p. 82.

of utilization of production capacity to be raised and creates a macroeconomic environment which is more favourable for the adjustment of the public accounts.

It is interesting to note that the adoption of the Act ensuring convertibility in Argentina was preceded (during the term of office of Erman González in 1990) by an attempt—similar in some respects to the policy applied by Economics Minister Marcilio—to achieve stabilization on the basis of high interest rates and fiscal adjustment measures. The failure of this attempt, and the change of incumbent in the Ministry of the Economy, with the appointment of Cavallo early in 1991, led to the decision to change the basic “anchor” of the stabilization process by replacing interest rates with the exchange rate.

The collapse of expectations of inflation and currency devaluation caused an immediate reduction in the risk premiums included in the interest rates on transactions in Argentine currency, and this helped to reactivate the economy. Moreover, the lifting of some legal restrictions on contracts and financial operations in foreign currency, together with the rigid link between the Austral (and later the peso) and the dollar made it possible to speed up the restoration of credit circuits. In conjunction with a restrictive fiscal policy and the sale of public assets, the reactivation of production and the decline in inflation led to a marked improvement in the public sector financial results.<sup>12</sup>

Many of the characteristics and difficulties of the Cavallo plan are typical of exchange-rate-anchored stabilization processes. Nevertheless, as we saw in the previous section, from its very beginning this plan involved much more than mere resort to exchange rate stabilization, since it also provided for full convertibility and contained an undertaking to keep the national-currency monetary base subject to the international reserves of the Central Bank. It should also be noted that these measures were not based solely on decisions of the Central Bank or the Ministry of the Economy, since they were established through an Act of Congress.

<sup>12</sup> See ECLAC, 1992a, pp. 7-10 and 65-73. Between 1990 and 1991, the financing needs of the non-financial public sector went down from 5.1% to 2.2% of GDP. This reduction was not due to containment of the overall level of expenditure. On the contrary, total expenditure increased in this period (albeit from low initial levels), rising from 23.2% to 24.1% of GDP. What happened was that there was a marked increase in current income (from 17.7% of GDP in 1990 to 20.5% in 1991), while capital income rose from 0.3% of GDP to 1.7% over the same period (ECLAC, 1992a, p. 66).

Consequently, the Argentine programme may be considered an unusually rigid variant of exchange-rate-anchored stabilization. It is this unusual rigidity which makes it so similar to the operating rules of the old Gold Standard, with the dollar occupying the place of a “sacred relic” in this case.

In view of the degree of deterioration reached by the Argentine economy, there may well have been no alternative to dollarization. Even if this assumption is accepted as true, however, it should be borne in mind that the path followed by Argentina is strewn with innumerable problems, and even in the best hypothesis it must be viewed as the lesser of various evils: a last resort for restoring the national currency in a situation of virtual collapse of the monetary and financial system.

Those who may perchance imagine that Brazil should follow the same road would do well to meditate not only on the well-known differences between the Argentine and Brazilian situations (degree of dollarization of prices, export structure, relative size of the Central Bank's international reserves, etc.) but also on the difficulties inherent in trying to restore the Gold Standard or something similar in the present conditions of the international and local economies.

It is one thing to adopt the Gold Standard when the main world currencies are already operating with this model, but quite another thing to adopt it in a world where the main currencies are fluctuating with respect to each other. A substantial rise in the value of the guarantee currency with respect to other currencies which are important for the trade transactions of the country in question may give rise to unmanageable balance-of-payments disequilibria, especially if this is accompanied by a local inflation rate which is higher than the international rate or if the programme had already begun with an over-valued exchange rate.

In Argentina, the effects of the real revaluation of the Austral/peso exchange rate with respect to the dollar which occurred before and after the Cavallo plan were aggravated by the rise in the value of the dollar *vis-à-vis* the cruzeiro in real terms at the end of 1991. For this and other reasons, an enormous increase in the trade deficit with Brazil has been taking place, and this has serious repercussions on the external accounts and Argentine industry.

As is generally known, the main world economies have adopted the system of floating exchange rates since the early 1970s largely because of the growing difficulty in maintaining fixed exchange

rates in a context of greater volatility and magnitude of international capital movements. For economies like those of Brazil or Argentina, however, which necessarily have much greater difficulty in sterilizing the monetary impact of external transactions, the volume and instability of capital flows greatly complicate the functioning of a fixed exchange rate system, since they subject the economy to alternating periods of undesirable expansion and abrupt contraction of the international reserves and domestic liquidity. Returning to a model analogous to the Gold Standard would merely aggravate the problems that Brazil is already facing in this field.

Similarly, a special feature of the Argentine and Brazilian cases is that the hyperinflation of the late 1980s came after a long period of chronic inflation. This helped to generate exceptional inflexibility of expectations and of the wage and price structure, in the sense of resistance to downward movements. In such a context, it is impossible to operate strictly in line with the rules of the Gold Standard. In these circumstances, the automatic adjustment mechanisms—which, it may be noted, have never functioned perfectly anywhere, even in the decades immediately before World War I—are even more inefficient. A marked loss of reserves, due for example to overvaluation of the currency, may ruin everything.

The essential point is that choosing an external monetary standard as a fundamental base means making the national currency subject to the future behaviour of the guarantee or reference currency. The problem is that movements of the guarantee currency depend primarily on the order of priorities of the State on whose authorization and sanction that currency depends. There is no reason to imagine that that order of priorities will always, or even often, coincide with the objectives and needs of countries like Argentina and Brazil.

This was precisely one of the main—if not the main—arguments put forward by Keynes against England's return to the Gold Standard in 1925. Such a return, he warned, would mean in practice establishing a rigid linkage between the City (the British financial centre) and Wall Street. The conditions of the United States economy would come to play a more important role in determining credit conditions in England than the needs of the British economy itself. "I appeal to the Chancellor of the Exchequer, the Governor of the Bank of England, and the other authorities responsible for deciding our fate in secret

to ponder over the perils involved in this procedure" he wrote in an article published in February 1925, using words which, *mutatis mutandis*, could well apply to the Brazilian situation towards the end of the Collor administration.

For Keynes, it was absolutely essential that Britain should keep control over its domestic credit system *in its own hands* (Keynes, 1981c, pp. 341-342), since it would be "a serious mistake to believe that in the long term the Americans will run their affairs in line with British interests" (Keynes, 1981b, p. 199). Would it not be true to say that what held good for Britain in the 1920s applies *a fortiori* to peripheral economies such as Brazil or Argentina?<sup>13</sup>

The European exchange rate crisis of 1992 is a recent illustration of the perils involved in using a foreign currency as an anchor. In 1990, the British Prime Minister John Major said that the system of fixed exchange rates, the so-called European Monetary System, represented an attempt to establish "a latter-day Gold Standard, with the Mark as an anchor".<sup>14</sup> That mechanism worked quite well as long as Germany's priorities were compatible with those of Britain and other more vulnerable economies of the European system, and it even helped to reduce inflation rates in such currencies as the pound sterling, the Italian lira and the Spanish peseta, but after the process of national reunification transformed Germany's economic situation, thus completely changing its priorities, countries like Britain and Italy had to suffer the economic consequences of a sharp

<sup>13</sup> Nevertheless, it is worth noting the contrast between the recommendations Keynes made in Germany in 1922 and his criticism of the decision to bring Britain back to the Gold Standard in 1925. In the case of Germany, as we have already seen, Keynes proposed an immediate return to the Gold Standard. How are we to explain these differing recommendations? Although a full reply to this question would call for an analysis of Keynes's thinking in this period, several explanations may be hazarded which are not necessarily incompatible with each other. The first is that Keynes preferred a return to the Gold Standard in a situation of great instability such as that observed in Germany in 1922, but not in the case of a more stabilized economy such as that of Britain. A second explanation is that Keynes, being a patriotic citizen, was more sensitive to the loss of monetary sovereignty when it was the fate of England that was involved. A third possible explanation is that Keynes's monetary thinking had evolved between 1922 and 1925 and was less and less in favour of the Gold Standard and pre-war monetary orthodoxy (see footnote 11 above).

<sup>14</sup> Quoted from an article in the *Financial Times*, London, reproduced in the *Gazeta Mercantil*, São Paulo, Distribuidora G.M. Jornal, 18 September 1992, p. 8.

divergence between their own needs and those of the country issuing the anchor currency. The result, as we well know, was a serious exchange crisis which finally led to the partial disintegration of the fixed exchange rate mechanism.

The initial success of the Cavallo plan was due largely to the fact that it was applied in an international situation of great expansion of liquidity and low interest rates for dollar transactions. This situation reflects the priorities of the U.S. Department of the Treasury, the Federal Reserve system, and the economic and political circumstances of that country

and of the rest of the developed world. It would only need a more pronounced shift in U.S. monetary policy, however, to jeopardize the Argentine anti-inflation programme by bringing out the potential conflict between national objectives and the Convertibility Act.

For the Brazilian and other Latin American economies, sticking to the rules of the Gold Standard was never an easy process, even in the heyday of that monetary standard. It would be very bold to imagine that it might be advisable to bring it back in the conditions prevailing today.

## V

### Dollarization, exchange lag, and the international reserves

*What is really involved when speaking of dollarization is the survival of national currencies in the face of the competitive challenge of other "superior" currencies such as the dollar.*

Pablo E. Guidotti and Carlos A. Rodríguez<sup>15</sup>

In spite of the above-mentioned problems, proposals for the dollarization of the economy have attracted a good deal of attention in Brazil since 1991, partly because of the initial success of the Argentine programme and partly because of the failure of successive attempts to stabilize the cruzeiro, either with traditional policies or through anti-inflationary measures centered on the freezing of prices or financial assets. In previous sections, I defended the view that the so-called dollarization represents, in essence, a regression to the rules of the old Gold Standard. Such regression means, as we have seen, subordinating the national currency to the dollar, whose movements depend primarily on United States priorities, with absolutely no reason to believe that such priorities will coincide with those of countries such as Brazil.

Furthermore, it should not be forgotten that dollarization measures are usually hard to reverse. This is particularly so in the case of decisions involving the partial or total lifting of legal restrictions on contracts and financial operations in foreign currency. In the 1970s and 1980s, several Latin American countries underwent gradual processes of dollarization in which the U.S. dollar was taking the place of national currency in the execution of all monetary functions. Generally speaking, these processes took place as a result of the liberalization of monetary and financial markets in economies suffering from inflation that was higher than the international level. The elimination of exchange controls and the authorization of residents to carry out operations in foreign currency led to a gradual reduction of the functions of the national currency, not only as a value reserve but also as a unit of account and even as a means of exchange (Guidotti and Rodríguez, 1991, pp. 3-4).

The experience of such countries as Bolivia, Mexico, Peru and Uruguay in the last two decades indicates that dollarization may be a path from which

<sup>15</sup> Guidotti and Rodríguez, 1991, p. 4.

there is no return. Once the economic agents have got used to operating with foreign currency, it is by no means easy to induce them to shoulder once again the costs associated with changing the monetary unit and to persuade them to abandon the historically most stable currency in favour of the national currency, even if it has proved possible to ensure an appreciable reduction in the rate of inflation. In other words, a decline in domestic inflation does not mean, in these circumstances, that the national currency will necessarily be used again more freely. On the contrary, in the 1970s and 1980s there were various episodes in Latin America where dollarization persisted, and even increased, in periods when there was a significant narrowing of the inflation gap with respect to the dollar.

In Bolivia, for example, deposits in dollars or expressed in dollars represented 84% of the total national bank deposits at the end of 1989, *more than four years* after the initiation of a successful stabilization process (Morales, 1991, p. 24). In reality, Bolivia is an example of a country where dollarization *kept on growing* in a period of substantial reduction of inflation.<sup>16</sup> When the stabilization process was begun in 1985, the degree of dollarization of the Bolivian economy was relatively low, thanks to a plan applied in 1982 which provided for the compulsory de-dollarization of foreign currency deposits in the local financial system. Dollarized deposits were permitted once again in 1984. Between 1985 and 1990, the degree of dollarization (defined as the ratio between foreign currency deposits and the combined total of M2 in national currency plus foreign currency deposits) increased almost continuously, standing at nearly 60% in 1989/1990 (Guidotti and Rodríguez, 1991, pp. 4, 4a, 5 and 8). This occurred despite a spectacular reduction in Bolivian inflation, which dropped from 8 171% per year in 1985 to an average annual rate of 17% in the period 1987/1990.<sup>17</sup> At the end of 1990, the degree of dollarization was high even in the case of current accounts, and foreign currency deposits accounted for almost half of the total demand deposits (Guidotti and Rodríguez, 1991, p. 5).

<sup>16</sup> For a recent analysis of the dollarization process in Bolivia, see Clements and Schwartz, 1992.

<sup>17</sup> The data refer to the December-December variation in consumer prices (ECLAC, 1992c, vol. I, p. 69).

Mexico and Uruguay went through similar experiences. Up to the mid-1970s, the degree of dollarization of bank deposits in Mexico was low and stable. With the outbreak of inflation which began in 1976 and some liberalization measures in the financial field, however, dollarization increased considerably. In 1977/1979, the Mexican Government managed to reduce the rate of inflation significantly, bringing down the differential between domestic and external inflation to the levels observed prior to 1976. However, the degree of dollarization of the economy, defined in the manner indicated earlier in this paper, did not go down, continuing to fluctuate around 15% up to 1981, when it rose again together with the inflation rate (ECLAC, 1992c, pp. 4a, 5 and 6).

In Uruguay, the process of dollarization has been stimulated since 1974 by a system of free convertibility of currencies and a financial system which accepts deposits in local or foreign currency at market interest rates. Moreover, since 1976 the Government has permitted trade and financial transactions to be expressed and paid in foreign currency, thus converting the latter into legal tender. In this context, and in view of the persistence of a significant inflation differential with respect to the dollar, dollarization advanced almost continuously between 1972 and 1982, in spite of a pronounced decline in Uruguayan inflation.<sup>18</sup>

The experience of these countries also reveals that the few episodes of de-dollarization have been involuntary. This occurred not only in Bolivia in 1982, but also in Mexico in the same year and in Peru in 1985. Except for these episodes, which included, among other measures, the compulsory conversion of existing dollar deposits in the local

<sup>18</sup> (ECLAC, 1992c, pp. 4a and 5). Basing their findings on the cases of Mexico and Peru, Dornbusch and Reynoso have also emphasized the difficulty of reversing the dollarization process: "If the change to safe assets is a gradual business, associated with a learning process, then two aspects should be highlighted. The first is that dollarization is not an instantaneous reaction to the slightest policy error. On the contrary, there is a substantial inertia, in the sense of maintaining existing assets. It is also true, however, that once the learning process is completed, it is difficult to reverse it. A return to moderate inflation rates is not rapidly rewarded with a *full* return of investments to local-currency assets" (Dornbusch and Reynoso, 1989, p. 489 (italicized in the original)).

financial system, the general trend in these economies has been towards progressive replacement of the national currency by the dollar. The fact that dollarization has only been reversed through compulsory measures strengthens the perception that it is to a great extent an irreversible phenomenon (Guidotti and Rodríguez, 1991, pp. 6 and 8).

In the case of Argentina, the problems inherent in dollarization are compounded by specific difficulties due to a particularly marked over-valuation of the real exchange rate. Contrary to what is sometimes said, the exchange "lag" was not due simply to inflation after the Cavallo plan which exceeded the inflation rate of the dollar, but above all to the marked revaluation of the Austral in real terms during the year before the adoption of the Convertibility Act.<sup>19</sup> The policy of high interest rates adopted during the period of office of Erman González in 1990 marks a difference in this respect from the policy of minister Marcfllo, since the latter tried to prevent the big differential between domestic and external interest rates from causing appreciation of the cruzeiro exchange rate in real terms.

In early 1992, there was no longer any doubt that the exchange "lag" was the main threat to the Cavallo plan. Because of the exchange rate appreciation in 1990, residual inflation even higher than the international level, and the inherent rigidity of the Cavallo plan, the Argentine economy seems particularly vulnerable at present to the economic cycles typical of stabilization programmes with an exchange rate "anchor". As a recent study by two World Bank economists recalls, these cycles usually begin with an expansionary phase, caused by the fall in domestic interest rates and the recovery of credit flows, but end in a recession, frequently associated with balance-of-payments crises (Kiguel and Liviatan, 1992, pp. 279-305).

The fall in real interest rates, due to the expectations of a real appreciation of the exchange rate and the reduction of the risk premiums, initially affects domestic absorption, which tends to exceed the recessionary effect of the exchange revaluation, especially in economies with little trade openness, such as

those of Argentina and Brazil.<sup>20</sup> The expansion of domestic demand is also usually stimulated by the recovery in real wages associated with the fall in the rate of inflation. To begin with, there is more rapid growth of the economy, which, together with the revaluation of the exchange rate, tends to produce a deterioration in the trade balance and the current account of the balance of payments. Depending on the availability of external credit, the current account deficit may be financed in this first phase through the absorption of external resources, partly stimulated by an interest rate differential greater than the expectations of a change in the exchange rate, as occurred in Argentina in 1991/1992.<sup>21</sup>

With the passage of time, however, the effects of the real appreciation of the exchange rate become more dominant, tending to lower the level of activity and give rise to uncertainty about the sustainability of the fixed exchange rate (Kiguel and Liviatan, 1992, pp. 282 and 296-298). At the same time, the cost of servicing the external debt increases, as a function of the indebtedness accumulated in the initial phase, and it also becomes more difficult to attract fresh capital from abroad, either because of the exhaustion of the possibilities for portfolio adjustment which were partly

<sup>20</sup> It should be remembered, however, that in the case of a dual-currency economy such as that of Argentina, the initial restoration of previous levels of production and use of installed capacity cannot be attributed solely to the recovery of credit and the fall in interest rates for operations in national currency. In 1991/1992, thanks to convertibility at a fixed exchange rate and the elimination of legal obstacles to contracts in dollars, there was a big increase in foreign-currency loans and deposits in the local financial system. Thus, deposits in foreign currency rose from US\$3.4 billion in March 1991 to US\$8.8 billion in June 1992, increasing over that period from 45% to 51% of total M3 in Argentine currency (Argentina, Ministry of Foreign and Religious Affairs, December 1991, pp. 4-5, and September 1992, pp. 4-5). With regard to the big expansion in the dollarized segment of the financial system after the application of the convertibility programme, see Fundación CEDEAL, 1992, pp. 12-14, 25 and 26.

<sup>21</sup> The expectations of an appreciation of the real exchange rate of the Austral/Peso and the reduction of the exchange risk coincided with a marked fall in interest rates on dollar operations in the international market. In 1991 and during most of 1992, the combination of these two factors provided the Argentine Central Bank with favourable conditions for reconciling encouragement of the inflow of external resources with the maintenance of interest rates on national-currency operations considerably below those observed in 1990. For statistics on the evolution of nominal and real interest rates in 1991/1992, see ECLAC, 1992b, table 33, and Fundación CEDEAL, 1992, p. 30.

<sup>19</sup> Between January and December 1990, the Austral/dollar exchange rate appreciated by over 40% in real terms (ECLAC, 1991, p. 23).

responsible for the previous inflow of capital, or because of the gradual reduction of the extraordinary profit margins made possible by the low initial value of national public and private assets. With the tendency towards expansion of the current account deficit and the first symptoms of a drop in the capital account balance, doubts also increase about the possibility of continuing to defend the exchange rate, which helps to further heighten the decline in the capital inflow. In these circumstances, the Central Bank is finally obliged to raise interest rates, thereby further accentuating the tendency towards contraction of economic activity caused by the appreciation of the exchange rate. As it already began with a lagging exchange rate, the Argentine programme ran into difficulties of this type relatively quickly, by the second half of 1992.

For the above-mentioned reasons, the problem of the exchange lag would not present itself in the same form in the Brazilian case. There are other difficulties of a different type, however. The degree of dollarization of the price system in Brazil is lower than that observed in Argentina in recent years (Pereira and Ferrer, 1991, pp. 5-15). Consequently, inflation after a possible freezing of the nominal exchange rate could be greater than the inflation registered under the Cavallo plan. The real exchange rate would begin in a more favourable position than that registered in Argentina, but on the other hand it would tend to suffer more significant appreciation after stabilization of the nominal exchange rate.

Furthermore, as the proportion of manufactures in Brazil's export structure is greater than in the case of Argentina,<sup>22</sup> it may be assumed that the export flows would respond more rapidly to an appreciation of the exchange rate in real terms. Therefore, in the Brazilian case a given exchange lag could have quicker and more destructive effects on the balance of payments. These problems are not necessarily unavoidable, but it would be necessary to consider them carefully when preparing any stabilization plan that involved the use of the exchange rate as a nominal anchor, especially if it were aimed to apply a programme as rigid as the Cavallo plan in Brazil.

Another difficulty lies in the relative size of the international reserves of the Central Bank of Brazil. As Gustav Cassel observed with respect to the monetary crises of the 1920s, if stabilization involves a

decision to link a new monetary standard to another standard which offers stable values and inspires confidence, the soundness of the new standard will depend primarily on the possibility of converting it immediately to the stable standard, and, hence, on the availability of funds to guarantee convertibility (Cassel, 1924, p. 225).

However, as the degree of dollarization of the private sector reserves is relatively low in Brazil, the ratio of the Central Bank's exchange reserves to the total liquid financial assets in cruzeiros appears to be as yet insufficient to maintain convertibility in the face of attacks by speculators, at least by comparison with the Argentine parameter. When the Cavallo plan was begun, the reserves declared by the Central Bank corresponded to no less than 64% of the total monetary or quasi-monetary assets in Argentine currency (see table 1). At the end of December 1992, however, the cash reserves of the Central Bank of Brazil were equivalent to only 34% of M2 and 17% of M4 (see table 2).

It should be noted that this difference is not due primarily to the fact that the Brazilian reserves are smaller than those of Argentina when measured according to the usual criteria for comparing the relative external liquidity of a country. The ratio of reserves to imports in December 1992, for example, was equivalent to 11 months' imports: i.e., almost 80% of the level registered in Argentina at the beginning of the Cavallo plan (see tables 1 and 2). The

<sup>22</sup> Between 1986 and 1991, industrial manufactures accounted for 27% of average total Argentine exports (Argentina, Ministry of Foreign and Religious Affairs, 1992, p. 6). In the same period, manufactures accounted for 55% of average total Brazilian exports (Brazil, Coordenação Técnica de Intercâmbio Comercial/Ministry of the Economy, Finance and Planning, 1991, p. 6). It should be noted, however, that the difference is smaller than would appear from a straightforward comparison of the statistics normally issued by the Argentine and Brazilian governments, since the Brazilian definition of "manufactured products" covers various goods that the Argentine government does not classify as "industrial manufactures". If the Brazilian statistics are adjusted on the basis of a comparison of disaggregated data on Argentine and Brazilian exports in 1991, the share of manufactures would fall, at the very least, to only 42% of total Brazilian exports, although this figure is still well above the share of 25% registered for Argentina in the same year. For detailed information on the breakdown by products of the Brazilian and Argentine export structures, see Brazil, Coordenação Técnica de Intercâmbio Comercial/Ministry of the Economy, Finance and Planning, 1991, pp. 10-13, and Melconian and Santangelo, 1992, p. 22).

TABLE 1

## Argentina: International reserves, monetary supply and imports

Period	International reserves <sup>a</sup> (millions of US\$)	Monetary base <sup>b</sup> (millions of US\$)	M3 <sup>c</sup> (millions of US\$)	Reserves/ monetary base (%)	Reserves/M3 (%)	Reserves/ imports <sup>d</sup> (months)
1990 (December)	6 013	6 435	10 954	93.4	54.9	19.4
1991 (March)	4 798	4 559	7 510	105.2	63.9	14.1
(June)	5 415	5 618	9 231	96.4	58.7	13.3
(September)	6 447	6 327	10 481	101.9	61.5	12.5
(December)	8 045	7 841	12 788	102.6	69.2	12.4 <sup>e</sup>

Source: Basic data: International Monetary Fund (IMF), *International Financial Statistics*, Washington, D.C., various issues; Argentina, Ministry of Foreign and Religious Affairs, "Argentina: principales indicadores económicos", Proyecto Relaciones Internacionales y Política Económica, various issues (mimeo); and Economic Commission for Latin America and the Caribbean (ECLAC), *Economic Panorama of Latin America, 1992* (LC/G.1680/Rev.1), Santiago, Chile, September 1992. Statistics prepared by the Centro de Análise Macroeconômica - CEMA/FUNDAP.

<sup>a</sup> International reserves of the Central Bank = Special Drawing Rights + foreign exchange reserves + gold (balances at end of periods in question).

<sup>b</sup> Mean daily balance.

<sup>c</sup> M3 = currency outside banks + demand deposits + savings deposits + fixed-term deposits. Mean daily balance.

<sup>d</sup> Cumulative imports of goods (FOB) over 12 months up to the month in question.

<sup>e</sup> Preliminary figures.

TABLE 2

## Brazil: International reserves, monetary supply and imports

Period	International reserves <sup>a</sup> (millions of US\$)	Reserves/ monetary base <sup>b</sup> (%)	Reserves/M2 <sup>c</sup> (%)	Reserves/M4 <sup>d</sup> (%)	Reserves/ imports <sup>e f</sup> (months)
1990 (December)	8 751	91.8	28.2	14.4	5.1
1991 (March)	7 468	88.2	21.6	11.4	4.4
(June)	9 225	116.4	27.2	13.4	5.2
(September)	7 054	117.6	22.7	11.2	4.0
(December)	8 552	144.1	23.7	12.6	4.9
1992 (March)	13 741	326.1	30.7	16.2	7.7
(June)	18 109	449.0	34.6	18.2	10.3
(September)	17 682	445.2	32.8	16.5	10.3
(December)	19 008	340.2	33.9	16.9	11.1

Source: Basic data: Central Bank of Brazil, "Nota para a imprensa", January 1993 (mimeo); *Gazeta Mercantil*, São Paulo; and Brazil, Coordenação Técnica de Intercâmbio Comercial/Ministry of Economic Affairs, Finance and Planning, "Balança comercial brasileira", various issues (mimeo). Statistics prepared by the Centro de Análise Macroeconômica (CEMA), Fundação do Desenvolvimento Administrativo (FUNDAP).

<sup>a</sup> Central Bank cash balances at end of periods in question.

<sup>b</sup> Monetary base = currency outside banks + bank reserves. Balances at end of periods in question.

<sup>c</sup> M2 = currency outside banks + demand deposits + federal, state and municipal securities in the hands of the public. As from March 1991, the figures include deposits by investment funds, and as from August 1991, special interest-bearing deposits of the Central Bank. Figures exclude demand deposits of investment funds and federal, state and municipal securities in the portfolios of financial institutions and investment funds. Balances at end of periods in question.

<sup>d</sup> M4 = M2 + savings deposits + private securities (figures include time deposits, bills of exchange and mortgage bonds, except those belonging to investment funds). Balances at end of periods in question.

<sup>e</sup> Cumulative imports of goods (FOB) over 12 months up to the month in question.

<sup>f</sup> Preliminary figures.

difference lies fundamentally in the much higher degree of demonetization observed in the case of Argentina.

It may even be recalled that in 1992 the international reserves of the Central Bank of Brazil partly consisted of funds resulting from the absorption of volatile or short-term external resources. Moreover, the way the negotiations with the foreign commercial banks are developing gives grounds for believing that Brazil could end up agreeing to immobilize a significant part of its reserves in order to guarantee some of

the public debt securities foreseen in the new agreement.

All these considerations suggest that it would not be advisable to apply the Argentine plan in the case of Brazil. Although the recent experience of Argentina and other countries may be very valuable in weighing the options open to Brazil, stabilization of the cruzeiro depends primarily on the possibility of formulating and applying solutions which take account of the special features of the Brazilian situation.

(Original: Portuguese).

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# Financing *decentralization*

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The financing of a State's sub-national levels of government, in federal and other systems alike, is an instrument of decentralization; first, each State has to decide what area of responsibility to assign to each governmental level and then it must design a suitable financing mechanism. If these sub-national governments' degrees of fiscal and administrative autonomy are not kept in alignment, then eventually the initiative may fail as the bodies at these levels gradually lose decision-making power within their sphere of responsibility. It is unlikely that sub-national levels of government will be able to cover all their financial requirements with their own funds. Instead, they receive differing amounts of funding from a whole series of financial sources, including their own tax receipts, a share of the central government's tax revenues and subsidies granted by the central government. Nevertheless, they achieve a high level of fiscal maturity when they are not heavily dependent upon the central government for financing. Independence is only possible when sub-national levels of government are financially self-sustaining or are financed by predictable resource transfers that have no specific conditions attached. What engenders the greatest degree of dependency, on the other hand, is financing based on tied resource transfers. The article cites a number of examples to illustrate how these funding sources operate in selected Latin American countries.

# I

## Introduction

Decentralization is the process of transferring areas of responsibility or authority from the central government to sub-national levels of government (state and municipal institutions in countries with federal systems, regional and community bodies in non-federal systems). Thus, we say that a State is decentralized when the local government agencies responsible for different zones within the nation's territory have been endowed with a significant degree of authority.

But in order for these sub-national levels of government to actually exercise the authorities transferred to them, they must have the necessary resources. The financing of federated states, regions and municipalities is therefore a fundamental topic in the study of decentralization, which, in most of the State reforms undertaken in Latin America during the past decade, has been seen not only as a bulwark of the State's democratization but also as a means of helping to make the allocation of authority and resources within the country more efficient.

Decentralization programmes whose design does not provide for an adequate flow of funding to the relevant sub-national government bodies are doomed to failure. The question is by no means a trivial one because, although decentralization has been justified as a means of reducing central government expenditure or achieving a more efficient allocation of public-sector resources, "in practice, however, the most immediate result of decentralization programmes in Latin America (e.g., Brazil, Colombia, Ecuador, Guatemala and Venezuela) has been to increase the central government's expenses as a consequence of a combination of factors: the legal requirements pertaining to formulas for intergovernmental resource transfers; the unexpected ramifications of income-distribution policies, which have worked as a disincentive for any increase in revenues on the part of sub-national units; the conditions imposed by central-government authorities with respect to the use of funding for specific purposes; and, most importantly, the limitations placed on sub-national governments' efforts to expand their revenue base" (Morgan, 1991, p. 10). It is clear, then, that unless more attention is paid to financial questions, the centralized nature of the tax system may lead to a "re-centralization" of administrative functions.

In short, the financing of the decentralization process needs to be based on an efficient allocation of powers and duties so that the various sub-national levels of government will have sufficient resources to assume the corresponding responsibilities within a context of autonomous decision-making and of equity among the various territorial zones making up the nation.<sup>1</sup>

The subject is a complex one not only because of the tensions inherent in the organization of a State having various levels of government and the consequent difficulty of allocating tasks and functions among its components, but also because the question of financing *per se* entails additional tensions owing to the diverse objectives being pursued, the wide range of instruments available, and the complicated relationships and juxtapositions among them (Giménez, 1979).

The efficient allocation of authority is in itself an enormously complex objective, since central government bodies are usually more efficient in performing some functions and decentralized bodies are more efficient in others; for example, the management of revenues is usually carried out more efficiently at the central level, whereas the mobilization of resources is often performed more satisfactorily at the local level.

As regards the objective of balancing the budget, when new functions are transferred to sub-national levels of government, then those levels' expenses will increase, and sufficient funds to cover them therefore need to be forthcoming. This generates a great deal of tension since, in situations where funding constraints (such as those currently affecting Latin America) are already making it difficult to balance the State's budget, a move towards decentralization can easily throw it out of kilter altogether; the reason for this is that usually, especially in the beginning, the central government will have to continue to take charge, at least partially, of the functions that have been transferred to other levels, and this inevitably entails some degree of inefficiency.

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<sup>1</sup> In regard to the current relevance of these concepts, see Castells (1991).

The funding for the activities that have been transferred to sub-national governmental units can be drawn from those institutions' own tax revenues or from State transfers. The use by such bodies of their own tax revenues is a hallmark of financial autonomy, whereas the use of State transfers—especially if the central government attaches conditions to that funding—is an indication of the extent of their dependency. The push and pull between autonomy and dependence is usually heightened if sub-national levels of government are fiscally irresponsible, since this will give rise to major conflicts between the State's macroeconomic objectives and the financial objectives of the country's regions and municipalities. If this situation is compounded by problems in connection with the various sub-national bodies' policies

regarding borrowing and deficits, then the tension between them and the central government will be exacerbated.

Finally, with respect to the objective of equity, it should be noted that sharp differences in the incomes of sub-national governments of equal rank may be reflected in disparities in the services provided to different areas within the same country; this makes some sort of income-leveling or equalization mechanism necessary, and the establishment of such a mechanism invariably generates inter-zonal tensions. Consideration also has to be given to the means of financing the measures taken to re-establish an inter-zonal balance through the alignment of the various territorial divisions' levels of development, since a different policy will be required in order to accomplish this.

## II

### Financing decentralization: a question of implementation

In the final analysis, the financing of sub-national levels of government is a secondary issue—or at least a question of implementation—for decision-makers concerned with the decentralization process. Each country must first decide how centralized or decentralized its services should be, and only then will it go on to determine what financing mechanism is the most appropriate. The decision as to the process of decentralization itself, on the other hand, is a policy decision; it must be based on constitutional grounds and must then be translated into a distribution of functions and authorities among the various levels of government. The State must first determine each governmental level's *quantum* of functions and authorities, and only then will it analyse how the corresponding activities are to be financed.

The fact needs to be borne in mind, however, that the correspondence between the administrative decentralization of government functions and fiscal autonomy is not exact, at least during the early stages of the process. A high degree of administrative decentralization means that decentralized regional or municipal bodies are able to take independent decisions regarding the responsibilities transferred to them, while a high degree of fiscal autonomy means

that they are able to decide independently what taxes will be assessed within their territorial jurisdiction. The two types of autonomy do not correspond, however, because decentralized services are generally funded—especially in non-federal systems—primarily by transfers from the central government, while only a very small percentage is covered by the decentralized governments' own tax revenues. These institutions' inability to generate any considerable amount of tax revenues on their own is not, in theory, an obstacle to the transfer of more responsibilities. However, if the lack of synchronization, which is understandable at the start of the process, persists over time, then the viability of the process itself may be jeopardized (Castells, 1991).

The decentralization of government functions can be measured by looking at the responsibilities actually transferred to sub-national governments; this transfer will be reflected in the share of the central government's public expenditure represented by that of the sub-national governments. The size of this share will not, however, tell us anything about the source of the revenues spent by sub-national governments. The concept of fiscal decentralization is what provides this information by means of various sorts

of measurements, which may denote different sorts of autonomy.

One way of looking at revenue sources is to determine which body has established the corresponding tax. Thus, we say that a financial model is centralized when taxes are primarily levied by the central government's Treasury, and the majority of the sub-national treasuries' incomes are provided by transfers from the national Treasury. In contrast, a financial model is said to be decentralized when each treasury department establishes its own taxes and derives the majority of its income from them, although it may still receive redistributive transfers from the central government (Sevilla Segura, 1991).

This criterion is not always used; sometimes fiscal decentralization is said to be determined by how autonomous a sub-national government is in terms of its expenditures, and it may have this type of autonomy regardless of whether it establishes its own taxes or receives automatic, predictable transfers from the State, such as those provided for under revenue-sharing schemes. This is why, for example, countries such as Argentina are included in the category of nations with a high degree of fiscal decentralization despite the fact that Argentina's federal system of finance is based on arrangements for sharing the revenues from the central government's taxes (World Bank, 1990).

Despite its implementational character, the issue of financing tends to introduce an additional contradiction into the administrative decentralization

process because in practice, especially during the early stages of the process, it entails a higher level of expenditure by government bodies as a group even though the quantity or quality of services may not increase.

A recent World Bank study of nine Latin American countries (Campbell, 1991) indicates that most decentralization strategies have resulted in significant additional net expenses (particularly in Colombia, Brazil, Guatemala and Venezuela). Although part of the reason for this may be that during the reorganization of governmental responsibilities, necessary improvements are made in the quality of services,<sup>2</sup> the fact remains that in most cases there has been no significant real reduction in the central government's expenses. And although some expenses may be temporary, experience shows that any reduction in central-government expenditure takes a long time to materialize and is never complete. Only in Chile, Ecuador and Argentina has intergovernmental financial reform been used as a tool of national budgetary restraint.

As a result of this situation, the decentralization process may fall into disrepute and the State may be re-centralized, with all previously-distributed functions being transferred back to the central government, simply because the authorities failed to find the right solution for these financial problems. In such cases, financing ceases to be simply an implementational aspect of decentralization.

### III

#### The allocation of functions and resources among the various levels of the bureaucracy and government

The allocation of powers and duties among the various levels of government is a complex subject which has been exhaustively studied from the perspective of economic analysis. Here we will refer only briefly to this topic as we seek to explore the issue of financing. For the purposes of this discussion we will therefore assume the validity of the traditional approach developed by Musgrave, which differentiates among three public-sector functions—allocation, redistribution and stabilization—and postulates that allocation,

consisting primarily of the provision of public goods, is the only function which should be performed by all

<sup>2</sup> Something along these lines took place in Brazil, for example, when the health services that had been in the hands of the federal government were transferred to the states and municipalities, since these services were in a shambles and large investments had to be made in order to continue offering them. In this regard, see Brakarz (1991).

levels of government.<sup>3</sup> This has given rise to what has been called the “decentralization theorem”, which holds that decentralization in the provision of public goods permits the diversification of supply according to the preferences of a country’s citizens, taking into consideration the existence of differentiated demands.

This theorem has a strong economic foundation in the proposition that the optimum provision of services can only be achieved on a decentralized basis; but it also has an important political component which distinguishes between decentralization and deconcentration, with the advantage of decentralization being that it introduces the element of elections as a mechanism for determining citizens’ preferences.

An economic analysis of government functions also serves as the basis for the other crucial statement we can make about financing: that, as a rule, it is not the job of sub-national bodies to establish taxes of a redistributive or income-leveling nature.

The allocation of responsibilities to the various levels of government is not, however, a theoretical process by which each function is assigned to the level that can perform it most efficiently. On the contrary, it is a highly complex procedure. The first necessary element is a political decision to embark upon the process of decentralization or, in the case of a State that is already functioning on a fairly decentralized basis, to carry it forward. Another consideration is the fact that not all sub-national government bodies of the same rank are capable of performing the same functions. Finally, the vertical allocation of functions is virtually impossible; the administration of most of the services provided by a State requires the involvement of various levels of government.

Decentralization is an issue that is now being debated in almost all Latin American countries, but their actual decentralization processes are very different from one another.

In countries with a federal system of government, the subject is one of the topics of the day, despite the fact that these countries are, theoretically, already decentralized. In these cases, the idea is basically to transfer more functions to the states than they

already have and to make those duties their exclusive responsibility; to establish systems of concurrent jurisdictions or spheres of responsibility; and to set up mechanisms for coordination with the central government and among the various states themselves. Although the processes themselves and the political formulas differ a great deal from country to country, as a rule the Latin American countries that have a federal system are more closely associated with the continental centralist tradition than with the North American federalist model. Some countries, such as Venezuela and Brazil, are currently analysing and implementing plans to carry the decentralization process further because their polity and civil society have decided that the state and municipal governments should take over the administration of more services from the central government (Shah, 1990; CLAD, 1991). Mexico’s society, on the other hand, is more inclined to have the central government be the one that provides services (ECLAC, 1985).

If the extent of decentralization is measured by the sub-national governments’ levels of expenditure, then the foregoing becomes obvious, since in Mexico their expenditure amounts to less than 20%, whereas in countries such as Argentina and Brazil, the figure approaches 30% of total expenditure (World Bank, 1988, using 1974-1986 averages).

In some countries that do not have federal systems, attempts have first been made to create regions that will function as decentralized units to which responsibilities can subsequently be transferred (Peru and Guatemala).

Finally, in another group of countries, the aim of decentralization is to reinforce local government at the municipal level (which is already a decentralized body) and transfer new functions to it (Colombia and Chile).

The financial issues are different in each of these cases. If decentralized bodies –even if they have few responsibilities and small budgets– are already in existence at the start of this process, then this means that decentralized treasury departments have already been organized, and such departments can serve as the basis for a new finance system. A relatively advanced position within the administrative decentralization process, as we would expect to see in countries having federal systems, ought, in its turn, to lead to an opening up of the fiscal decentralization process whereby financing based on central-government resource transfers to sub-national bodies would gradually

<sup>3</sup> While Musgrave’s economic analysis (1991) is still relevant, it can now be questioned from some standpoints.

give way to the use of revenues from taxes assessed by the latter, which would manage their own incomes and be answerable for that management to the electorate. This was apparently one of the objectives of Brazil's reform of its fiscal system, where the debate surrounding the subject of financing not only referred to the financial self-reliance of the Brazilian states in covering their expenses, but also to their autonomy in attaining a position of self-reliance.

There is, none the less, another difficulty associated with decentralization, and this is that sub-national governments' finances are often shaky even before the bodies at these levels assume their new responsibilities, which may make state, regional and local governments reticent about the entire process. Therefore, rather than seeking to encourage the transfer of functions based on technical criteria, central governments often attempt to transfer funds over to sub-national bodies without any prior agreement as to the transfer of functions and without requiring their assumption, which may lead to financial difficulties.

Instead, when new, decentralized bodies are created, they need to be given treasuries of their own as well. Moreover, the financial problems faced by federated states or regions are obviously different from those that arise in municipalities.

The allocation of functions is complicated by the fact that states, regions and municipalities usually lack the necessary management capacity to assume their new responsibilities all at the same time.

In theory, there are three types of transfer systems:

(i) A system of transfers *en masse*, in which the functions to be decentralized are transferred to all the various territorial levels of government in one fell swoop. Theoretically, this would forestall the financial disorganization of the central government since the resources to administer a given service would be transferred at the same time as the responsibility for the service itself; however, this approach may generate a large number of management problems for the newly decentralized government agencies.

(ii) A system of piecemeal transfers, in which the decentralized bodies are the ones that must request that a given responsibility be transferred to them

from the central government once they feel that they have sufficient management capacity to administer the new service; this system offers some advantages to sub-national government agencies, but it gives rise to all sorts of imbalances in the central government; even more importantly, expenditures increase.

(iii) A combination of the two above systems, whereby the preferred course of action is for sub-national governments to take the initiative; thus, when these governments request that they be given a specified responsibility, it is immediately transferred to them; however, if a certain amount of time has passed without the corresponding responsibilities or functions having been requested, the central government may decide on its own to transfer them *en masse*. This system initially has a destabilizing effect and generates diseconomies of scale, but it ensures that the system will operate more smoothly in the future. Most of the countries have used some variation of this approach.

At this point reference should be made to shared or concurrent functions. When there are various levels of government, it is impossible to separate the different jurisdictions entirely because all functions are performed within the same territory; thus, in this case conflict and decentralization are consubstantial. Although it may seem paradoxical, studies on decentralization indicate that it is more feasible to minimize this conflict when the distribution of responsibilities is not rigid and the various levels are assigned concurrent functions, which makes negotiation and consensus-building an essential element in the provision of the service in question. Even if jurisdictions are not rigid, however, it is important for the law to define exactly where the boundary between different government responsibilities lies. In such a situation, administrative and fiscal maturity is called for in order to resolve the conflicts that arise.

In view of the foregoing, it is clear that, for any given configuration of jurisdictions in terms of their assignment to different levels of government, a financing scheme should be devised that will provide decentralized agencies with sufficient resources to render the services for which they have been given responsibility. There is, however, no general financing model that is shared by most federal or other forms of government.

## IV

### The resources available to decentralized government bodies

The resources used to finance sub-national levels of government may come from a variety of sources. Essentially, these sources fall into three general categories: (i) taxes levied by that level of government; (ii) a share in the central government's tax receipts; and (iii) central-government subsidies.

To differing extents, decentralized bodies use all three types of sources. The amount of funding that such bodies derive from their own taxes is almost always very small, however, so transfers of central-government revenues or subsidies provide the bulk of the financing. This is what is known as financial dependence: sub-national government bodies depend upon the central government to fund the services they provide. Their degree of financial dependence is a function of the financing instrument chosen, which may or may not restrict their autonomy in respect of expenditures; such dependence is greatest in the case of conditional, or tied, subsidies.

Some studies simply exclude tied or non-automatic transfers from the range of sources for sub-national government income that they consider. Actually, however, the degree of dependence is not associated with particular types of systems for financing decentralized bodies. Moreover, there is no reason why sub-national levels of government should be opposed to dependence upon the central government; they may in fact prefer such a system, even at the risk of losing autonomy, either for economic

reasons (considerations of efficiency together with the ready mobility of goods and persons that a differential fiscal treatment may afford) or for political reasons (considerations relating to the political cost of taking unpopular fiscal decisions). Viewed from another vantage point, a position of dependence may signal sub-national governments' inability to be financially self-sustaining (Suárez Pandello, 1988, pp. 79 and 80).

Sub-national bodies' dependence upon the central government to fund decentralized services has two major implications (Sevilla Segura, 1991):

(i) Sub-national governments may easily lapse into fiscal irresponsibility, since they obtain the funding they need without having to bear the political cost of levying taxes on their own constituency. Since this political cost falls only upon the central government, sub-national governments tend to pressure the central government for more resources.

(ii) The central government, for its part, will then try to ensure a high degree of dependency and will tie the provision of resources to sub-central levels of government to the fulfilment of certain conditions. Tied subsidization is thus a major source of income for decentralized bodies which restricts the autonomy of the corresponding sub-national level of government.

Let us now take a closer look at these types of funding sources and at some examples of their use in Latin America.

## V

### Fiscal autonomy through self-generated income

Although, as noted earlier, administrative decentralization and fiscal decentralization do not—at least during the initial stages of a decentralization process—necessarily go together, it is also true that the

very dynamics of the process demand that as time goes on, decentralization will increasingly be financed by taxes assessed and collected in the sub-national territorial jurisdictions themselves, since this

is the only lasting solution for the financing problems which affect both decentralized bodies and the central government.<sup>4</sup> This is because the needs of sub-national government bodies grow so fast that they will inevitably jeopardize the central government's ability to balance its budget and to continue providing the services assigned to it, as well as performing its stabilization and redistributive functions. What is more, the autonomy of a decentralized body will be severely undermined if its funding institution attaches strings to the financing it provides. Nevertheless, setting up a system of taxation is no easy task because it requires a level of fiscal maturity throughout the entire territory which is unlikely to be found in Latin America and because, for all intents and purposes, certain kinds of taxes are beyond the reach of sub-national government bodies for economic reasons.

Although self-generated income may be classified in various ways, for the purposes of this analysis we will define it as income from taxes or charges received by the corresponding governments in accordance with stringent criteria of territoriality; in other words, the tax receipts of a government having jurisdiction over the location in which they were collected. These include taxes to which only the decentralized body is entitled; taxes to which the decentralized body shares its entitlement with another institution by virtue of surcharges or other sources that permit double taxation; and territorially-based tax sharing. In contrast, entitlement to a share of State taxes based on some criterion other than territoriality, as in the case of subsidies or general transfers, is defined as a revenue-sharing arrangement. It is important to bear in mind, however, that the terminology used in this connection varies from country to country and from author to author, and sometimes arrangements for sharing in tax receipts of any sort whatsoever may be regarded as a transfer or subsidy. On the other side of the coin, in reference to the autonomy or dependence of a sub-national government, some authors classify tax sharing as a

form of self-generated income. The subject is of particular relevance in Latin America, where the sub-national bodies in countries having federal systems derive the bulk of their funding from such arrangements.

A word should also be said here about taxes to which the central government is entitled but which are collected by other levels of government. For our purposes here, these taxes will be regarded as corresponding to the central government if it holds legal title to those receipts; it is true, however, that participation by sub-national governments in the administration of such taxes can play an important role in enhancing their own fiscal accountability and perhaps even attaining higher collection rates.

Economic analysis suggests a number of technical guidelines for attributing the different sources of tax revenue to the various levels of government.

Musgrave (1991) offers the following guidelines: (i) mid- and lower levels of government should use the least inter-jurisdictionally mobile tax bases; (ii) graduated personal taxes should be used by the jurisdictions in which a comprehensive base can be most efficiently applied; (iii) graduated taxes levied for distributive purposes should be a tool of the central government; (iv) taxes used for purposes of stabilization should be levied by the central government, while those used by lower levels should be cyclically stable; (v) tax bases whose distribution among sub-jurisdictions is highly unequal should be used by the central government; (vi) taxes based on the benefit principle and user taxes are appropriate for all levels. This scheme therefore assigns consolidated income taxes, taxes on expenditure, taxes on natural resources and public service charges to the central level; income taxes for residents and non-residents, destination-point sales taxes, taxes on natural resources and public service charges to mid-level government; and property taxes, payroll taxes and public service charges to local government. Matthews later added the observation that tax-sharing formulas needed to be devised to offset fiscal imbalances between different levels of government (see Castells, 1988).

There are two ways in which decentralized bodies can establish their own taxes; these two approaches are by no means mutually exclusive:

(i) *Dividing up the various revenue sources.* Under this "complementary treasury" system, some sources are reserved for the central government and some for decentralized bodies; this poses a problem,

<sup>4</sup> Strong evidence to back up this statement is provided by the present crisis of the system used to finance Spain's decentralized State. Although this system has been very successful in transferring functions over to what are known as the Autonomous Communities, the financing problems that have arisen can only be resolved by increasing the share of funding provided by the Communities' own tax revenues. For a discussion of the current controversy, see Castells (1991) and Sevilla Segura (1991).

however, since good sources of tax revenues (primarily income and sales taxes) are limited, and if the best sources are reserved for the central government, as the above economic analysis would seem to suggest, then the autonomy of decentralized bodies cannot be guaranteed. A good example of how these revenue sources may be distributed is provided by Brazil's Constitution of 5 October 1988, which seeks to ensure an ample degree of fiscal autonomy for decentralized agencies (articles 153-156): the Federal Union is vouchsafed the taxes on imports, exports, income, manufactures, credit operations, exchange and insurance transactions, and the transfer of bearer bonds and securities, as well as rural land taxes and taxes on large estates; the federated states and the Federal District are entitled to inheritance and gift taxes, taxes on motor vehicle ownership, turnover taxes and service taxes; and the municipalities are assigned the taxes levied on urban real estate and property, the transfer of real estate and rights thereto, retail fuel sales and some services. This allocation of sources of revenue reserves a very high-yielding tax (income tax) for the Federal Union, but it also grants another, very elastic, tax (the turnover tax on goods and services) to the federated States and the Federal District, which at least theoretically should ensure some degree of fiscal autonomy for the latter. The municipalities are granted the traditional sorts of local taxes, which have low yields, and special charges and rates based on the benefit approach.

(ii) *Allowing each autonomous body to establish its own taxes using a system of parallel treasuries.* This system may lead to double taxation (e.g., an income tax levied by the State and another established by the corresponding sub-national government). Although double taxation is not objectionable *per se*, it may cause problems if its aggregate effects on the public sector as a whole and on the private sector are not taken into account. In addition, it may create complications for the general public by giving rise to a profusion of similar types of tax provisions; consequently, the countries in which double taxation exists have tended to reduce the number of instances where it arises. (The frequency of double taxation in the United States, for example, has been reduced considerably.) A system of parallel treasuries can, however, be easily implemented if the system is structured around the central government treasury

and autonomous bodies are then allowed to add surcharges on to the central government's taxes. This second system of taxation is not incompatible with the first. A system of financing could be devised whereby some sources of tax revenues are reserved for a given entity while other bases can be taxed by a number of different bodies. For example, Brazil's Constitution provides that, in addition to the taxes they may assess on their own tax bases, the federated states and the Federal District may also place a surcharge on the income tax levied by the Federal Union. A similar system is now being proposed in Venezuela which would involve surcharges on national income taxes or on excise, sales or value-added taxes. In this last case, the system would allow governors to add a few extra percentage points to the tax assessed by the national government (De la Cruz, 1989).

The two systems of decentralized taxation described above provide autonomous bodies with a high degree of political autonomy and fiscal responsibility, since they will then decide how much to tax their constituencies. The principle of autonomy demands that the level of taxation should be decided by each decentralized body individually, although this is sometimes done at the national level. For example, Brazil's value added tax (VAT) is administered by a council on which all the states are represented, and any change in the tax must be approved by that council.

Non-federal countries in which the regions have taken on the status of autonomous entities can also provide for the assessment of regional taxes. The Basic Regionalization Act of Peru (Act No. 24650 of 19 March 1987) provides, as one of the resources available to regional governments, for "any taxes they may create pursuant to legislative authorities delegated to them". Similarly, Bolivia's Departmental Governments Organization bill provides for the generation by each region of resources of its own.

In countries that have no plans to convert national regions into decentralized entities (whether they have federal systems or not), some provision is none the less made for the municipalities to generate some resources of their own, although the amount of these receipts is not great, since they are primarily obtained from public service charges and property taxes. When a country wishes to speed up the decentralization process, however, steps are usually taken to increase this type of municipal income. As part of Colombia's municipal decentralization programme,

for example, Decree-Law 1333 (04/1986) updates the Municipal Code, which contains legal provisions (Act No. 14 of 1983) that authorize the municipalities to augment the taxes on, *inter alia*, land, industry, commerce, advertisements and billboards, circulation and transit, parks and landscaping, entertainment and casinos. More recently, Act No. 44 (12/1990) and principles set forth in the country's new Constitution (of 1991) regarding sub-national territorial jurisdictions are having the effect of promoting autonomy in relation to taxation and of strengthening the regional and local economic base.

A third category of self-generated income is tax sharing, i.e., the receipt of a share of central-government tax revenues in accordance with territorial criteria, i.e., based on the amount of tax revenue collected in each autonomous entity. Tax collection and tax management in general can be performed directly by the central government or by the sub-national governments themselves. Strictly speaking, these are transfers from the central government to sub-national levels of government. The central government is legally entitled to the tax and it determines the base to which the tax will be applied, as well as the type of levy to be used (unlike the above cases), but all or part of the receipts from the tax will subsequently be distributed according to the proportion of those receipts collected in the corresponding territorial divisions; the amount to be distributed will not, however, be influenced by considerations of population size, economic factors, equity among the various territorial divisions of the country, etc.

This type of financing also has certain advantages as regards the autonomy of decentralized bodies because each zone's receipts will be directly related to its fiscal capacity. This makes the decentralized body accountable to the electorate and hence gives it a measure of independence from the central government, especially if the sub-national body is involved in administering the tax. However, not all taxes can be parceled out on the basis of territorial jurisdictions; what is more, this type of financing will not eliminate vertical or horizontal disequilibria within the State and, in fact, creates many problems when it is the only criterion used for transferring income to sub-national units.

The importance of this issue was clearly demonstrated in Mexico, which had traditionally based its

fiscal decentralization on the sharing out of State taxes to the country's various territorial divisions.

As long as Mexico's tax receipts came primarily from taxes on production and consumption, and the contribution from PEMEX was quite small, the system's method of distribution was territorially based, with the principle being that each component of the federation should receive what it had helped to create. Then, however, the introduction of a value added tax (VAT) –a tax that would be difficult to regionalize– and the rise in oil prices, which benefited some states much more than others, triggered a major change in the system which gave expression to concepts relating to the interdependence of the Mexican states and equity. Some elements of the system's former territorial basis are still left, however, and article 2 of the Fiscal Coordination Act of 1980 stipulates that those states belonging to the Fiscal Coordination System which coordinate their taxes on real estate sales are to receive an additional percentage in the General Apportionment Fund (which is tantamount to the sharing of tax revenues) and an 80% share of the receipts from taxes on motor vehicle ownership and use in their territory provided that they collaborate in the collection of those taxes.

Brazil's Constitution also provides for a very important territorially-based mechanism for the sharing of revenue which has an especially significant impact on the country's municipalities (article 158); the Constitution draws a very clear distinction between this mechanism and the transfers provided for in article 159, which will be discussed at a later point. Under these provisions, the municipalities are entitled, *inter alia*, to: 50% of the Union's receipts from the rural land tax that are collected within their boundaries; 50% of the Union's receipts from the tax on the ownership of motor vehicles whose licenses were obtained in their district; and 25% of the State's receipts from the turnover tax, from taxes on inter-state and inter-municipal transportation and communications services.

Peru plans to use this same type of tax-sharing system to distribute the receipts from the national tax on profits obtained from the development of natural resources to the regions in which those resources are located.

## VI

### Vertical and horizontal disequilibria

All fairly decentralized countries experience what has come to be called vertical disequilibria, which are the discrepancies that can arise between autonomous agencies' incomes and their expenses. This fiscal shortfall is covered by transfers from the central government to sub-national levels of government and is reflected in the latter's dependence upon the former.

Experience has demonstrated that the amount of income taken in directly by sub-national levels of government is insufficient to cover their expenses. Subsidies or transfers represent an attempt to offset this disequilibrium through a redistribution of the fiscal resources available to public-sector bodies as a group; such resources are therefore channeled down from the higher levels to the lower levels since, on the whole, the lower levels suffer from a shortage of funding (Castells, 1988, pp. 69-70).

There are two reasons for this disequilibrium: the slow growth of the sub-national governments' self-generated income, and the increasing amount of expenses being concentrated at those levels of government. Thus, the extent to which vertical fiscal disequilibria become a problem will depend primarily on what degree of fiscal autonomy each decentralized entity has attained by generating income of its own and how functions and responsibilities have been allocated. Obviously, the disequilibrium will be more severe in countries such as Mexico, where the federal government's revenues are based on more

elastic taxes (e.g., income and sales taxes) and the federated states' own revenues come primarily from land taxes, and less severe in federations such as that of Brazil, in which the sales tax has been assigned to the federated states.

The second cause of this disequilibrium, i.e., increasing expenses, is a factor in all countries, but the extent of its impact will depend on how the various government functions have been allocated. In Mexico, for example, the decentralized entities' scant measure of autonomy in respect of taxation has been dealt with by reducing the states' and municipalities' duties;<sup>5</sup> in this case, then, the authorities have resolved the problems associated with fiscal decentralization by reducing the country's administrative decentralization.

In addition to the problem of vertical disequilibrium, a horizontal disequilibrium may exist among units of the same level of government (federated states, regions or municipalities) as a result of a lack of correspondence between their tax capacity and their expenses. Not all such units will have the same amount of income, or the same tax capacity, and some means of re-establishing a balance will therefore be needed. Equalization subsidies or transfers are often the means chosen to ensure that the poorer units will have access to services comparable to those available to the wealthier ones. In some cases, the same type of transfer may be designed to correct both vertical and horizontal disequilibria.

## VII

### Transfers: modalities and purposes

We have just said that transfers or subsidies are the tools used to deal with both horizontal and vertical disequilibria. There are many types of such mechanisms, and they may be classified on the basis of various criteria. The main problem with these classifications is that a given transfer may be included in different categories depending on the criteria selected.

One type of classification is based on the criteria used to determine the total amount involved. One possibility is for the amount of a subsidy to be expressed as a fixed percentage of the central government's income when such income is to be shared out

<sup>5</sup> Regarding the case of Mexico, see ECLAC (1985).

among the various levels of government. This type of system is known as "revenue sharing", which is so named because the subsidy is a percentage of the State's revenues. In Peru, for example, Act No. 25.193 (30 January 1991) stipulated that in 1991 all receipts at the national level from income and wealth taxes should be transferred to the regional governments. Subsequently, the 1991 Annual Budgetary Act for the Public Sector and the State Entrepreneurial System (Act No. 25.294 of 15 January 1991) qualified the provisions of the above-mentioned law, stating that the transfer of income-tax receipts to the regional governments would amount to 50% in 1991 and that the executive branch would programme the remaining 50% in the 1992 budget. This is an example of a transfer made under a revenue-sharing system.

Leaving aside the question of territorial distribution (in which case we would no longer be dealing with a subsidy but rather with a form of self-generated income referred to in the literature as "tax sharing", as has been discussed earlier in this article), subsidies may be classified according to whether the transfers are allocated in accordance with a pre-established formula, on a discretionary basis or as a reimbursement for specified expenses. A formula-based form of distribution is, theoretically, preferable because it is based on objective, measurable criteria; this procedure is frequently used for such mechanisms as Brazil's and Chile's common municipal funds. Discretionary transfers are used, in particular, for infrastructure works by many countries, and may be based on objective, technical evaluations of proposed projects or on purely political considerations. Nevertheless, in some countries discretionary transfers have been used because basic problems relating to the distribution of government revenues have not been resolved. This was the case of National Treasury contributions in Argentina, which were in use between 1983 (when the law relating to revenue sharing expired) and 1987 (when the new law on this subject was enacted). The best course of action, whenever possible, is to design transparent, stringently-defined mechanisms for the provision of such subsidies.

Finally, we have placed subsidies intended to reimburse a decentralized body for specific expenses into a separate category (e.g., the expenses incurred by a municipality when it takes on new functions such as the provision of health or educational

services) regardless of whether the size of the subsidy is based on an established formula or is discretionary in nature.

Another relevant classification refers to whether the subsidy has conditions attached to it or not. The usual procedure is to divide them into general, or untied, and tied subsidies. The latter, in turn, can be classified in many different ways according to their degree of conditionality. Untied subsidies impose no conditions whatsoever on the sub-national governments regarding the use of the funds. Tied subsidies, on the other hand, restrict the use of the corresponding funds to certain sectors or specific projects and may, in addition, establish other requirements of a more or less restrictive nature even within the specified sector or project. For example, a subsidy given to the health sector may carry the condition that the funds be spent on hospital beds and may also require that, in order to be eligible for the subsidy, the sub-national government must demonstrate it is capable of providing a certain level of primary health care services. Conditions relating to tax collection are of particular interest. Argentina provides a good example of this type of transfer; in order for the provincial governments to be eligible for a share of revenues, they must draw up and implement a financial action plan for avoiding fiscal deficits. Along the same lines, the fiscal reforms currently under discussion in Venezuela would provide for the co-administration of national taxes, particularly the VAT; under this arrangement, it would be the states' job to supervise the collection of these taxes, and the amount of funds transferred to them (based on their yields) by the central government would therefore depend on how well they do that job.

Subsidies may also be classified as fixed-sum or proportional subsidies, according to whether the subsidy is a set amount or a percentage of the sub-national government's expenditures; this latter arrangement introduces an additional element—cost-sharing by sub-national governments—that may foster greater financial restraint on the part of sub-national governments when designing projects and may encourage them to increase their tax capacity for generating income of their own. Another possibility is whether to place a cap on the subsidy or not.

A final category that should be mentioned here draws a distinction between equalization subsidies and subsidies that do not have that aim. These

income-leveling subsidies are intended to correct horizontal fiscal imbalances among decentralized agencies of the same type.

All these classifications provide a wide array of options for the allocation of resources based on a

combination of one or more features, each of which has its own theoretical justification, advantages and disadvantages. In the following section we will discuss some of these modalities and see how they have been used by a number of countries in Latin America.

## VIII

### Revenue-sharing

This heading refers solely to the origin of a subsidy, not to how it is subsequently spent. Revenue-sharing is considered to be equivalent to a general subsidy, and one of the major issues it raises therefore concerns the lack of a link between the share of revenue and the revenue actually generated by the corresponding jurisdiction. In Latin America revenue-sharing plays a very important role in providing central-government tax receipts to finance the states' operations in countries with federal systems of government and in financing the municipalities.

The problem which these transfers are intended to resolve is the inadequate finances of sub-national governments, although they also sometimes incorporate considerations of inter-jurisdictional equity.

Of course, in a sense all transfers involve sharing in the income of another governmental agency or level, but the distinguishing trait of those included in this discussion is that the amount of the transfer is fixed as a given percentage of the receipts from one or more taxes which are then distributed among the various sub-national jurisdictions without reference to the tax effort made by each, although some type of incentive may be provided in this regard.

This system has its origin in a fund that was set up in 1966 in the United States when the federal government set aside 2% of actual receipts from the personal income tax (levied on a net basis rather than on the amount of receipts) in order to form a fund that would then be distributed among the states according to the size of their populations. From a theoretical perspective, this raises an interesting problem as to whether this type of income should be classified as one that contributes to a sub-national government's autonomy or to its dependence. In Latin America, this has taken various forms, some of which will be discussed below.

In Brazil, article 159 of the new Constitution establishes a State Apportionment Fund which is

financed by the federal government. The federal government must deposit 21.5% of its receipts from income taxes and from the tax on manufactures in this fund, which is then distributed by the Council of States to each state in the federation. It should be noted that the above percentage is calculated on the basis of actual tax receipts (the result of applying the tax rate to the net base) rather than the tax base itself. In determining the size of each state's share, 85% of the fund is reserved for distribution among the northern, north-eastern and mid-western states while the remaining 15% goes to the states in the south and south-east of the country. This initial distribution of the fund seeks to uphold the objectives of regional equity. A subsequent redistribution is based on a formula that takes into account the size of the states' populations and an indicator of tax capacity which is inversely proportional to those population groups' per capita incomes.

In addition to this fund, the Constitution establishes two other federal revenue-sharing mechanisms: 3% of the receipts from the above-mentioned taxes is set aside for the implementation of financing programmes for the production sector in the northern, north-eastern and mid-western regions of the country through their regional financial institutions, as provided for in the regions' development plans; and 10% of the receipts from the tax on manufactures is transferred to the states and the Federal District, with their shares being proportional to the value of their respective exports of manufactures.

The Brazilian Constitution also establishes a Municipal Apportionment Fund. This fund is very similar to the fund set up for the states; its resources come from a 22.5% share in the receipts from income taxes and from the tax on manufactures and are distributed to the municipalities based on the size of their populations and their per capita incomes.

Colombia's and Venezuela's constitutionally-mandated transfer payments and Mexico's General Apportionment Fund are quite similar, although in these cases the shares are percentages of total revenues rather than of specific tax receipts.

Colombia's revenue-sharing mechanism, which is established by its Constitution and has recently been modified, sets a minimum percentage of current income that must be transferred to the governments of the country's departments, for education and health services. The new criteria to be taken into account in its distribution are the affected population, these services' objectives and basic needs, and the entities' administrative effectiveness and tax efforts. These criteria have also been incorporated into the new Constitution, and regulatory proposals also would provide for the possibility of decentralizing health and educational services as far down as the municipal level.

In Venezuela, a special, constitutionally-mandated item is included in the budget for distribution to the states, Federal District and federal territories "in the following manner: 30% of this percentage [is to be distributed] in equal parts and the remaining 70% in proportion to the population of each of the aforementioned entities. This item will amount to no less than 12.5% of the relevant budget's total current income estimate ... The corresponding Basic Act shall determine the municipal entities' share of the budget item" (article 229 of the Constitution).

The reforms recently implemented in Venezuela with a view to increasing the country's political, administrative and fiscal decentralization have entailed major changes in this field. The Basic Act for the Decentralization, Delimitation and Transference of Governmental Responsibilities of December 1989 repealed the pre-existing Special Budget Item Coordination Act and set forth more equitable distribution procedures by means of the following provisions: (i) the special budget item was set at 16% of the budget's total current income estimate, with this percentage increasing by 1% per year until reaching an annual figure of 20%; (ii) the states' budget acts would include an item earmarked for the municipalities, which for 1990 was to amount to 10% of total current income. This percentage, too, was to be increased annually until reaching a level of 20% and was to be distributed in accordance with the Basic Act on Municipalities.

Mexico had traditionally used a tax-sharing system based on how much was collected by each entity, but this was modified by the Fiscal Coordination Act of 1980. The explanatory statement for this legislation described the amendments as follows: "shares shall not be granted on the basis of the collections obtained in each entity but shall instead be placed in a General Apportionment Fund, to be charged against all federal taxes, which shall be distributed to the entities under the terms of a new Fiscal Coordination Act and of agreements concluded with the Federation by any states wishing to do so. Said agreements shall also set forth the powers for administering the tax to be exercised by the federated entities".

The new system is chiefly based on two agreements between the states and the federation: the Fiscal Coordination System Membership Agreement and the Administrative Collaboration Agreement. Three funds were set up for the system's operations: the General Apportionment Fund, the Supplementary Financial Fund and the Municipal Development Fund (ECLAC, 1985).

The General Apportionment Fund is made up of 13% of the federation's total annual income from taxes and other duties on hydrocarbons, natural gas and mining. For purposes of distribution, only actual collections are considered. Each state is guaranteed an amount equal to what it received the year before plus an increase calculated on the basis of a formula that takes into account each state's tax effort in respect of the collection of federal taxes within its territory. This particular formula, which incorporates a rating of the State's tax effort in determining the size of the transfer payment, helps to narrow the gap between income and expenditure associated with the tax-sharing arrangement and is not only of economic importance, but of political significance as well, in that it increases the sub-national governments' fiscal accountability.

A Supplementary Financial Fund has also been created using 0.50% of the federation's total annual income from taxes and other duties on hydrocarbons, 3% of the General Apportionment Fund and a like amount charged to the federation itself. This Fund's resources are distributed in inverse proportion to the per capita shares received by each entity from the General Apportionment Fund.

Finally, the Municipal Development Fund has been drawn from various types of income and is initially distributed to the states in accordance with

rules similar to those applying to the General Apportionment Fund; the states then distribute the funds among their municipalities pursuant to the rules laid down by their local legislatures.

Argentina's new Federal Co-Apportionment Act, which has been in force since 1988, provides that, initially, 42.34% of the relevant funds will go to the central government and 57.66% to the provincial

governments. The funds to be apportioned in this manner are the receipts from the VAT and from the profits, capital, fuel and other lesser taxes. The subsequent distribution of these funds among the provinces is influenced more strongly by territorial than by demographic criteria, but does provide for larger transfer payments to areas in which a larger number of poor households are concentrated.

## IX

### Transfers as reimbursements for specific expenditures

Another very important type of transfer in Latin America is a payment intended to reimburse a decentralized entity for particular expenditures. This mechanism is a very useful one, especially during the early stages of a decentralization process, because it enables the central government to transfer a function to a sub-national level while at the same time transferring the resources needed to perform it; in principle, this allows both the national budget (which is relieved of an area of responsibility at the same time that the corresponding resources are transferred) and the decentralized entity's budget to be balanced.

This is, for example, the procedure set forth in Venezuela's Decentralization Act of 1989, which provides for the transfer of each sphere of responsibility together with the budget allocation used by the central government to provide the service in question. A similar procedure has been used fairly successfully in Chile for the transfer of certain types of health and educational services to the municipalities (Castañeda, 1990).

Chile embarked upon a series of sweeping educational reforms in 1980 which involved, among other changes, the transfer of the pre-primary, elementary and secondary schools to the municipalities. To this end, the school infrastructure was transferred to the municipalities under the terms of a special agreement, while the money to pay teachers' salaries was transferred from the Ministry of Education to the municipalities. In addition, this same Ministry is providing the municipalities with a subsidy to defray educational expenses, which are calculated

using a formula based on enrolment. In the health sector, in 1981 the government also began to transfer medical centres and clinics to the municipalities. Under the financing arrangements for this transfer, the municipalities are paid for the health care they provide using an invoicing system that is referred to by its acronym, FAPEM. FAPEM is an advance-payment and reimbursement system having 15 categories of primary care services, for each of which an amount is provided that covers outlays for goods and services, personnel and maintenance.

A similar arrangement was established in Brazil for the health system, but at the state level; it differs from Chile's system, however, in that the size of the subsidy is set by agreement rather than on the basis of a formula. Brazil recently created what is known as the Consolidated Health System (SUS) by transferring basic units and regional hospitals, as well as doctors and system administrators (although the latter continue to be paid by the federal government), to the states and municipalities. The distribution of SUS resources is carried out by means of an integrated planning system; under this system, an estimate is made of the health care needs to be covered and the investments to be made in each health district. The estimates are prepared on the basis of an epidemiological profile for each district, the number of hospital admissions or office visits made the year before, the installed physical network (public and private) and other variables. Health district plans are consolidated for each state, which prepares its own plan of action, and are then sent to

SUS national headquarters. The sums to be allocated to each state are determined at meetings attended by the state secretaries and the Minister of Health (Brakarz, 1991).

This type of transfer is characterized by a marked level of dependency upon the central government and a high degree of conditionality, since the funds received must be used for a pre-established purpose.

## X

### Equalization or distributive transfers

Although some revenue-sharing transfers usually incorporate considerations of equity, most of the financing systems for decentralized entities include some type of special transfer payment whose purpose is to shift resources from the richest to the poorest entities with a view to ensuring a basic minimum of public services and solidarity among the nation's different territorial divisions. Thus, while some of these objectives may be incorporated into such mechanisms as revenue-sharing arrangements, the possibility of making additional transfers for this purpose is not ruled out. Venezuela's fiscal reforms, for example, include not only modifications in the country's constitutionally-mandated subsidies but also the creation of an Interregional Solidarity Fund.

The guidelines used for this type of transfer payment vary a great deal, but the basic purpose is to take resources from the richest zones and give them to the poorest.

Chile's Common Municipal Fund fits this definition, since it provides for a large transfer of resources from the richest districts, or communes, and from the State budget to the poorest communes. In fact, this is the latter's chief source of funding.

This Fund is composed of the following resources (DL 3063, Municipal Income Act):

- (i) 60% of each commune's land tax receipts (the other 40% remains within the relevant commune as part of its own resources);
- (ii) The fiscal contribution stipulated by the public-sector's budget act;
- (iii) 50% of motor vehicle registration fees;
- (iv) 45% of commercial license fees in the commune of Santiago; and
- (v) 65% of commercial license fees in the communes of Providencia and Las Condes.

The Fund's resources are distributed among the communes of the country in accordance with the following provisions:

- (i) 10% in direct proportion to the number of communes;
- (ii) 20% in direct proportion to the population of each commune;
- (iii) 30% in direct proportion to the number of properties exempted from the land tax in each commune; and
- (iv) 40% in direct proportion to the lower level of permanent per capita income in each commune as compared to the national average.

The law also states that the municipalities should, whenever possible, use the resources from this Fund for the creation, maintenance and provision of services to the local community.

## XI

### Conclusions

The topic of fiscal decentralization, or of the financing of sub-national levels of government, is of instrumental relevance to the process of decentralization. A decentralization initiative calls for political and administrative decisions about how the State

and the government service of each country are to be organized; once this process has begun or, at the least, once a model of governmental organization has been designed, then the financing of the decentralization process takes on great importance, since

the question of how decentralized bodies are to finance the functions transferred to them will have to be resolved. Political and administrative decentralization initiatives may end in failure unless they are coupled with a parallel process of fiscal decentralization. In addition, decentralization is sometimes justified on financial grounds (e.g., the efficiency of public resource allocation within the State), and the subject should therefore be studied and analysed when the relevant political and administrative issues are being explored.

There is no exact correspondence between the administrative decentralization of government functions and fiscal autonomy in the sense that transferred services must be financed by the relevant sub-national governments. The relationship between the two will, of course, depend upon the nature of the decentralization process itself. Nevertheless, if there is no synchronization of the two forms of autonomy whatsoever, then the viability of the decentralization process as a whole may be jeopardized, since a lack of fiscal autonomy entails, to some extent, a more limited degree of political and administrative autonomy. In order for a decentralized system of administrative functions to reach an advanced stage of development, decentralized units must have a high degree of fiscal autonomy.

The autonomy of a decentralized entity does not hinge solely on its ability to finance its activities with its own resources; its capacity for deciding how to spend the income it receives from the State is also a factor. Sub-national entities receive various types of income from the central government. Generally speaking, such an entity will only be autonomous in terms of its expenditures if it is financed with its own resources or when the funds it receives take the form of revenue-sharing or of automatic, predictable, untied transfer payments.

The financing obtained by decentralized entities from their own taxes is invariably quite limited in Latin America, where such entities are marked by a high degree of financial dependence, since most of their resources come from the central government. The extent of their dependency will vary according to the type of source from which their financing is

drawn. In general, when sub-national governments do not finance the services they provide with their own resources, they may easily lapse into fiscal irresponsibility (since they do not have to bear the political cost of levying taxes), while the central government may tend to ensure a high degree of dependence upon it and try to control sub-national governments by providing them with transfers and specifying how they must be spent.

Be that as it may, transfers from the central government will always be necessary because financing based on self-generated resources, in whole or in part, generates disequilibria. These imbalances may arise either because of a differential between autonomous governments' sources of income and their expenses (vertical disequilibria) or because the incomes and expenditures of different governmental units at the same level do not correspond (horizontal disequilibria).

There are many different types of financing instruments available, ranging from various sorts of self-generated income (i.e., revenues collected by a sub-national body within its own territorial jurisdiction which are parallel or complementary to the national system of taxation) to tied transfers (i.e., those made in cases where the central government takes major decisions about how the transfers are to be spent). The choice of instruments has important implications for sub-national governments, and all of them are used in Latin America for different purposes; thus, the system applied in each country is a mixture of a number of different financing modalities. These instruments include, for example, the revenues from State taxes that are obtained by a sub-national entity on the basis of territorial criteria (and, hence, based on its fiscal capacity), which bolsters the entity's fiscal autonomy; tax sharing on a basis other than territoriality, which deals with the problem of disequilibria in an efficient manner but also breaks the connection between the origin of income and the consequent expenditure; and various sorts of transfers, tied and untied, which are also used to eliminate disequilibria but in so doing provide the central government with a greater measure of control.

(Original: Spanish)

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# Intraregional migration *of skilled manpower*

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Concern about the international migration of skilled human resources has traditionally focused on migratory flows to industrialized countries, i.e., about what has come to be known as the "brain drain". There are, however, migratory movements of this segment of the labour force within the region as well. This "horizontal" migration is analysed briefly in the present article; in so doing, the author reviews its causes, possible implications, the characteristics of these flows of skilled migrants, and the relationship between what is to be observed in some countries and the official attitude adopted by their Governments. This examination suggests that the emigration of skilled human resources, regardless of their destination, is invariably a loss for developing countries owing to these resources' high social value and economic cost. The author concludes that the subject calls for in-depth research at the intraregional level.

# I

## Introduction

Some time during the 1960s, the emigration of professionals and technical personnel –or, in other words, skilled manpower– to the industrialized countries became a cause of concern for developing countries, and since then has been the subject of numerous studies and debates in international forums. The emigration of these groups, especially when the move is a permanent one, poses a different sort of situation than the departure of other segments of the labour force because it occasions the loss of valuable and expensive human resources who are needed to help raise the population's level of well-being and to spur progress in the fields of health, scientific research, technology and culture. This consideration is what makes studies on the migration of skilled manpower of singular importance.

The migration of these groups, which has generally been perceived as a "problem" for developing countries, has been regarded as one aspect of the unequal economic relations existing between the developing and industrialized countries. This view has been reflected in the term "brain drain", which suggests that the phenomenon is some sort of indirect subsidy of rich countries by poor countries.

In Latin America, the brain drain has sparked a great deal of interest, owing mainly to large-scale migration from Latin America to the United States. In the course of the debate on the subject, this outflow of skilled manpower came to be regarded as a distinctive component of one of the region's major patterns of international migration, i.e., emigration to the United States.

For the most part, the study of this phenomenon started out by focusing on its possible implications in terms of the social and economic well-being of source countries, and only later has consideration been given to the factors which trigger migratory movements. For various reasons, studies on the subject have devoted very little attention to migration between developing

countries. None the less, an examination of those same studies demonstrates the need to include the subject of migration by skilled manpower between such countries. A consideration of this topic raises a number of questions relating to the countries of Latin America, and an attempt to address those questions will be made in the present essay.

First, the emigration of human resources who possess skills considered to be valuable to a given developing country would seem to represent a social and economic loss for that country, regardless of the emigrants' destination; thus, the current interest in studying the causes and consequences of the migration of skilled manpower can properly be extended to include flows between developing countries, rather than being confined to the portion of the brain drain flowing towards industrialized countries. Second, we need to know more about the migration of skilled human resources between Latin American countries and about any specific traits these resources may exhibit, as well as about the characteristics and scale of the flows themselves. Third, the above-mentioned aspects need to be considered in the light of the Governments' official attitudes towards international migration. The purposes of such a comparison are to ascertain the extent to which concern about the migration of skilled manpower between Latin American countries has come to be associated with concerns about the brain drain flowing towards developed countries; to determine whether a genuine effort has been made to seek solutions for the overall problem of the emigration of skilled human resources; and to see how closely the response forthcoming from some countries' Governments corresponds to the observable situation in those countries.

In addressing these concerns, this article reviews the chief aspects of the international migration of skilled manpower between Latin American countries, analyses its causes and consequences, and offers some theoretical observations regarding the importance of these migratory flows and the attitudes adopted by the Governments as reflected in official reactions to international migration, particularly of skilled manpower within the region.

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■ This article is based in part on original research conducted by the author (Martínez, 1992) during the preparation of the thesis submitted by him in 1988 to the Master's Programme in Population and Development of the Latin American Demographic Centre (CELADE).

## II

### The international migration of skilled manpower between developing countries

Generally speaking, the emigration of skilled manpower –i.e., of highly educated segments of the population– from developing countries has been a cause of concern because industrialized countries have been the main destination of these migratory flows (the “brain drain”).<sup>1</sup>

Unlike the “brain drain”, the migration of skilled manpower from one developing country to another is a horizontal process; in other words, it takes place between countries in a similar economic position, some of which are relatively more developed than others. This relatively higher level of development may be reflected, for example, in better social services (such as health and education) or in more progress in certain economic sectors or, perhaps, in more jobs and better wages. Social, economic and political circumstances may, of course, influence migratory trends over time, but it is unlikely that they will reverse those trends.

There is no question about the fact that developing countries need to make full use of their skilled human resources to promote their social and economic well-being (CELADE, 1977). Thus, for them, the emigration of these resources constitutes a problem whose severity will depend, *inter alia*, on the scale and characteristics (selectivity, permanence, fields of specialization involved) of the flows and on the size of the country’s supply of those resources. Even if the volume of the flow is small in relation to the national supply, however, emigration remains a problem for reasons that will be discussed later.

<sup>1</sup> This discussion does not touch upon a more general issue that may be of great interest in the future: the international mobility of the population, which includes the movements of individuals. This phenomenon may have something to tell us about the new forms of mobility that can be expected in coming years as a consequence of, among other factors, the increasing openness of national markets, as well as the behaviour of various economic agents involved in the process of economic globalization. See, in this regard, Pellegrino (1992).

#### 1. Determinants and the levels at which they operate

If we can identify the different levels at which determinants of the migration of skilled manpower operate, then those determinants can be ranked in a way that will contribute to a better understanding of the influence they exert in both source and destination countries. Attributing the phenomenon entirely to generalized international forces is tantamount to denying the influence of personal decisions and fails to explain why other skilled groups having similar characteristics do not emigrate.

The relationship among the various levels of causality would appear to be shaped by the conditions imposed by structural factors upon more specific, parallel processes. In an essay originally focusing on the brain drain, Portes (1977, pp. 351-369) draws a distinction among determinants at the international level (primary), the structural domestic level (secondary) and the individual level (tertiary).

The primary factors would thus be the political and economic differences observed at the international level between central and dependent countries. Within Latin America, these differences are manifested in the existence of countries that serve as “sub-centres” and others that act as “sub-dependents” within the larger framework of the region’s economically dependent position in world markets. These differences in the patterns of accumulation and the development of productive forces under fairly similar conditions of dependency gives the sub-centres a relative measure of autonomy in the management of their production resources and preferential access to higher-ranking positions. The result is the emergence of a limited number of enclaves that attract the bulk of intraregional immigration to specific areas within certain countries. In the case of horizontal migration, a hallmark of these primary determinants is that they operate on the basis of asymmetries which are less marked than those existing between central and dependent countries.

Thus, horizontal migration of skilled manpower is caused, at a primary level, by the existence of an intraregional structure in which some economies are subordinated to the interests and priorities of other, generally stronger or more developed economies owing to certain advantages enjoyed by the latter, such as higher wages, better technical conditions for professional advancement, more social recognition, less restrictive living conditions and more political stability, as well as larger-scale operations by transnational corporations. These advantages are nothing more than what is commonly known as "preference differentials" (Otefza, 1971, cited in CID, 1981; also Portes, 1977, pp. 351-369). The countries having the greatest advantages will be those which, using the instruments provided by their immigration policy, are in a position to heighten the effect of preference differentials in order to attract human resources to certain economic sectors.

These primary factors are not the only causes of migration, however, since, if they were, countries having all or many of these advantages would not see any significant number of individuals emigrating to other countries of the region, as they in fact do. In other words, primary factors' chief influence has to do with immigration to a given country and they suggest the simultaneous presence in that country of a number of these advantages over a considerable time period.

Hence, other factors also are at work in the migration process within the framework of the international and, especially, intraregional structure. The internal processes taking place in countries from which there is a great deal of emigration constitute the secondary factors involved in the migration of skilled manpower; these factors have to do with emigration from the home country and, in combination with preference differentials, help trigger migration.

The internal conditions that constitute these secondary factors are primarily imbalances between a country's capacity to produce highly-qualified resources and its capacity for absorbing them; this type of disequilibrium is found even in advanced societies (Portes, 1977, pp. 351-369). According to a study conducted by the Latin American Demographic Centre (CELADE), it is not simply that the educational system is turning out a surplus of qualified human resources; the main problem is the production system's limited ability to make use of those resources and, paradoxically, the repeated appearance of severe deficits in fields vital to a country's economic and

social development, such as medical services or scientific and technological research (CELADE, 1979, pp. 5-37).

This disequilibrium has been described as a "structural tension" (Hoffman-Nowotny, 1983; Portes, 1977, pp. 351-369) that has a differential effect on highly qualified groups because a given country's educational system is geared to preparing human resources for a level of development it has simply not attained. Thus, we are faced with an absurd situation: if a country raises its population's levels of academic training, it will be encouraging emigration (Kidd, 1967, cited by Portes, 1977, pp. 351-369). Emigration would thus have the effect of re-establishing a balance between what professionals have to offer and what the production structure demands, which would reduce structural tension and the anomie people feel as a result of this situation.

In some cases, structural tensions are associated with a lack of opportunities; in others, this is compounded by an imbalance between the opportunities that do exist and the high level of training achieved. In other words, professionals in the poorest countries emigrate primarily in search of employment, whereas the professionals of countries in a better international position emigrate either in search of employment or in search of better opportunities commensurate with their high educational level. In either case, emigratory pressures are being generated.

It follows from the above that a country at a relatively higher level of development would witness a greater degree of selectivity among its emigrants and would also, at the same time, be receiving immigrants. A country that is more developed than others may attract a large number of professionals, but the structural tension within it may also be pushing many of its own professionals out of the country.

Identifying the emigratory factors associated with structural tensions that are acting as secondary determinants sheds more light on the reasons for the migration of skilled manpower, but it does not explain why some individuals do not emigrate. The answer must be sought at the level of the individual, where factors are at work that will help round out our understanding of the phenomenon; these are the tertiary factors.

Individual or tertiary factors that may ultimately play a role in the decision to emigrate include, for example, wage levels, family situations and professional incentives (Portes, 1977, pp. 351-369). These variables are related to the type and level of an

individual's professional training and to his or her social relationships. Put simply, in a given field of specialization, the higher the level of training, the more limited a person's family obligations, and the greater the extent of inter-personal stimulus, then the greater the chances that a person will emigrate.

In short, as shown in table 1, the three levels of causality, when taken together, contribute to an understanding of the horizontal migration of skilled human resources, beginning with the specific

effects of primary factors in terms of flows between economically dependent countries. It is important to ensure the viability of effective policies for dealing with emigration, and in order to do so, policy measures need to be focused on the internal processes or structural tensions that prompt valuable human resources to emigrate or, in other words, on striking a basic qualitative and quantitative balance between the supply and demand for skilled manpower.

TABLE 1

**Horizontal migration of skilled human resources:  
determinants**

Factors	Primary	Secondary	Tertiary
Level	International	National	Individual
Characteristics	Horizontal differences in the political and economic structures (preference differentials)	Imbalances between the output of skilled resources and the capacity to absorb them (structural tensions)	Type and level of professional training, context of social relationships (personal decisions to emigrate)

Source: Author.

## 2. Overall losses

The consequences of the emigration of skilled manpower can generally be regarded as social and economic losses for developing countries, where a full utilization of the countries' qualified human resources (which are urgently needed but, paradoxically, for which there is no actual demand within the production system) is essential for the promotion of social well-being. This continues to be the case regardless of which country the emigrants choose as their destination.

The overall effects of emigration should not be measured or assessed solely on the basis of the number of emigrants, which might in some cases seem negligible and lead to an incorrect diagnosis of the situation. The more important issue has to do with the characteristics of emigrants and their line of work, since their departure may lead to the disappearance of a given specialty (Rodríguez, 1982). Thus, the consequences of emigration are primarily social and economic and are occasioned by the loss of expensive human resources that are valuable from a development standpoint.

First of all, regardless of the emigrant's destination, there is always the loss of an investment which

the country had hoped to recover through the individual's contribution to society; this loss can be quantified on the basis of the direct costs of the individual's education (Chaparro, 1971). This loss is greater if the emigration is permanent or long-term and if the professions of the emigrants are ones with above-average training costs.<sup>2</sup>

Another overall effect is the loss of production resources: the human resources who emigrate cannot be used by the country that trained them, and this represents a decrease in its production capacity (De Sierra and Petrucci, 1979). According to Chaparro (1971), this problem has been addressed from two different vantage points: the inputs of leadership, creativity and dynamism forthcoming from highly qualified persons, and the services which these persons can provide, especially in certain occupations that are considered to be of strategic importance.

<sup>2</sup> Actually, in the case of emigration to industrialized countries, calculations of the net loss should also take into consideration, *inter alia*, compensatory international assistance and the probable positive effects (remittances) of emigration. Another variable that should be factored in is the recovery of the investment afforded by a number of years of work in the home country after graduation and before emigration.

As noted by this author, emigrants usually include a large percentage of persons with specializations in which there is a manpower shortage (such as scientific and technological research); these are also generally the more "modern" occupations in which personnel are in demand in advanced countries.

The foregoing provides grounds for the conclusion that the emigration of skilled manpower is both a quantitative and a qualitative problem. The greatest social and economic losses will be sustained by the

less developed countries; these countries have a smaller national supply of human resources to start with and emigration from them is highly selective in the sense that the emigrants making up these flows are concentrated in crucial specialties, are at the age of greatest intellectual productivity and remain for a long time in the destination country. These losses become more severe if the number of emigrants is large, if emigration is sustained over time and if the return rate is low.

### III

## Migratory flows of skilled manpower within Latin America

There has been a great deal of publicity in the region about one of the hallmarks of intraregional migration: the presence of a large number of unskilled migrants moving between neighbouring countries, many of whom do so illegally. Particularly well-known cases involving large numbers in absolute terms are those of Colombians in Venezuela and of Paraguayans, Chileans and Bolivians in Argentina. A parallel phenomenon is the "brain drain" flowing towards the United States (and forming part of the migration to that country), which has become a cause of concern because of the large number of skilled Latin Americans residing there and, obviously, owing to its social and economic implications.

The data indicate that intraregional migration is not confined to unskilled individuals and that, in addition to the brain drain represented by the outflow of skilled Latin Americans to the United States, intraregional migration of skilled manpower is also taking place. This brings to light the importance of studying horizontal migration.

#### 1. Information and its sources

Population censuses are currently the only source of information for the study of intraregional movements of skilled migrants, which may be regarded as a basic step in the analysis of horizontal migration. Census information on migrants in the professional, technical and related categories covers the foreign-born (immigrant) population present in a country; this, by extension, can be used to identify the population groups

born in a given country that have left it to reside in other countries which have also gathered information on their foreign populations (emigrants). Thus, the term foreign population can be generally defined as being composed of those individuals who are in a country other than the country of their birth at the time of the census and who have answered the census question regarding place of birth.

The migrants covered by such information are drawn from a country's stock of immigrants, i.e., from the total number of surviving immigrants in a country; this information can be used to arrive at an approximate estimate of the total number of migrants who have left their country of birth (not including returnees) during the time period considered and who have been enumerated in countries which have taken censuses around that time. It should therefore be borne in mind that when we refer to an individual migratory flow, we are actually using data regarding a number of different flows.

The information used here was gathered in the censuses taken during the 1970s and 1980s in Latin America and, in some cases, in those conducted by the United States during the same period. These data have been provided by the Investigation of International Migration in Latin America (IMILA) Programme of CELADE, whose purpose is to gather information from population censuses on Latin Americans present in countries (primarily within the region) other than that of their birth.

Some qualifying statements are called for regarding the data's relative lack of chronological

synchronization, the migrants' place of study, the migrants' length of stay in the receiving country, the failure to define refugee status,<sup>3</sup> and the variable quality of the information. As regards the supply of information, for the censuses of the 1970s as well as of the 1980s IMILA has detailed tabulations on 11 of the 20 Latin American countries covered by the programme, and information from both census rounds is available for only seven of these. This means that the total number of emigrants from the various countries cannot be determined, which in some measure affects any comparisons with migration to the United States.

## 2. The situation according to the 1970s and 1980s censuses

A comparison of the total number of skilled intraregional migrants with the total number of skilled Latin American emigrants present in the United States reveals that the percentage of the latter is greater than

of the former during the period under study: 64% versus 36% around 1970 and 65% versus 35% around 1980 (see table 2). This bears out the general view of the magnitude of the Latin American brain drain constituted by migratory flows to the United States, and is thus hardly a surprising finding. What is remarkable, however, is the large proportion of Cubans and Mexicans in the United States and in overall migration to that country, but since these flows of emigrants are occasioned by very specific situations, this phenomenon will not be analysed here. Another way of gauging these flows is therefore to factor out the Cubans and Mexicans present in the United States; this having been done, the comparison yields quite a different result: skilled intraregional migrants then outnumber those who go to the United States, with the figures being 55% versus 45% for both periods (see table 2); this means that there are indeed large-scale migratory flows which are concentrated in the region (considering 11 Latin American countries only).

TABLE 2

### Latin America: emigrants in the professional, technical and related categories residing in the region and in the United States, around 1970 and 1980

Region of residence	Around 1970 <sup>a</sup>		Around 1980 <sup>b</sup>	
	Number	%	Number	%
Latin America	39 404	35.6	73 646	34.8
United States	71 195	64.4	138 002	65.2
<b>Total</b>	<b>110 599</b>	<b>100.0</b>	<b>211 648</b>	<b>100.0</b>
Latin America	39 404	54.9	73 646	54.7
United States (not including Cubans and Mexicans)	32 401	45.1	60 999	45.3
<b>Total (not including Cubans and Mexicans in the United States)</b>	<b>71 805</b>	<b>100.0</b>	<b>134 645</b>	<b>100.0</b>

Source: Jorge Martínez P., *La migración de mano de obra calificada dentro de América Latina*, LC/DEM/G.126, series A, No. 275, Santiago, Chile, CELADE, 1992, October.

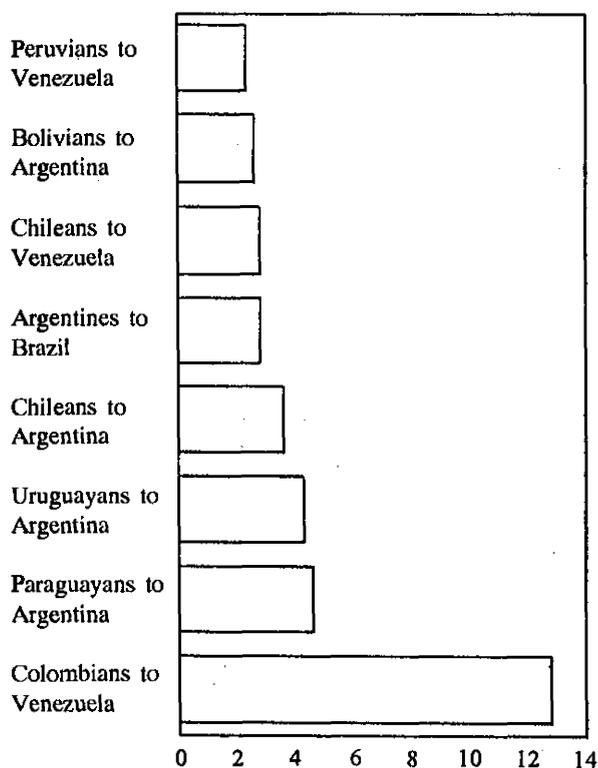
<sup>a</sup> Includes 11 countries that conducted censuses (Argentina, Chile, Costa Rica, Dominican Republic, Guatemala, Haiti, Mexico, Nicaragua, Panama, Paraguay and Venezuela) for the total number of resident foreigners corresponding to the 20 countries covered by the Investigation of International Migration in Latin America (IMILA) Programme being executed by CELADE.

<sup>b</sup> Includes 11 countries that conducted censuses (Argentina, Bolivia, Brazil, Chile, Costa Rica, Ecuador, Guatemala, Panama, Paraguay, Uruguay and Venezuela) for the total number of resident foreigners corresponding to the 20 countries covered by the IMILA Programme being executed by CELADE.

<sup>3</sup> To provide some idea of the magnitude of this phenomenon, in the 1970s about 100 000 persons are thought to have emigrated within the region for political reasons, according to the Office of the United Nations High Commissioner for Refugees (UNHCR) and the Intergovernmental Committee for Migration (ICM). See CID (1981).

Some of the nationalities of skilled emigrants that are most heavily concentrated in the region are Paraguayans, Uruguayans, Bolivians, Chileans and Colombians, in that order, and the presence of these groups, in turn, is especially notable in two countries

FIGURE 1  
**Latin America: main flows of professional,  
 technically-trained and related emigrants  
 within the region, around 1980**  
 (Thousand of persons)



Source: Jorge Martínez P., *La migración de mano de obra calificada dentro de América Latina*, LC/DEM/G.126, series A, No. 275, Santiago, Chile, CELADE, 1992, October.

(Argentina and Venezuela). Around 1980, these flows accounted for more than one half of all intraregional migrants (Martínez, 1992). Figure 1 shows the main flows of emigrants in absolute terms, by country of destination; the largest such flows are directed towards Argentina, Venezuela and, to a lesser extent, Brazil.

Perhaps the most salient point here, at a descriptive level, is the existence of a connection between the proportion of skilled personnel in the economically active population (EAP) and the distance between the home and recipient countries; this is illustrated by the cases of Chileans and Peruvians in Venezuela and Argentines in Brazil, as well as by other, smaller flows. Generally speaking, the greater the distance involved, the larger the proportion of skilled labour among the economically active migrants as a group.

Table 3 shows that Venezuela, Argentina and Brazil, in that order, receive the largest numbers of migrants from within the region, with some of the major flows being made up of Colombians going to Venezuela; of Paraguayans, Uruguayans and Chileans moving to Argentina; and of Argentines and Chileans headed to Brazil. In the majority of cases, the flows involve immigrants from neighbouring countries. In Venezuela, skilled immigrants make up a significant proportion of the country's professional and technical personnel (around 7%).

With regard to countries of origin, as may be seen from table 4, Colombia, Chile and Argentina, in that order, have been the sources of the largest numbers of emigrants. Colombia and Chile have the largest percentages of emigrants in the professional, technical and related categories relative to their national totals. Colombian emigrants are not only concentrated within the region, but specifically in Venezuela. Chilean emigrants mainly go to Argentina, although the concentration is less marked.

Emigration is also a significant phenomenon in other countries of the region, such as those of Central America and the Caribbean. Since most of the emigrants from these countries go to the United States (Dominicans, Haitians, Nicaraguans, Panamanians and Salvadorans), an analysis of intraregional migration in relation to these countries is of less interest, despite the quite significant figures for Costa Rica. None of the Central American countries individually exceeds any of a number of South American countries as a source of intraregional emigrants (Martínez, 1992).

The main facet of this regional situation that is of interest to us here, in any case, is that migration of skilled human resources is indeed taking place and that the size of these flows is far from negligible in comparison to migration to the United States. It is also clear that countries such as Venezuela, Argentina and Brazil are particularly attractive destinations; this would appear to be associated with the larger size and higher level of development of their economies. This suggests the presence of at least some sort of advantages in these countries—better wages for professional occupations, for example—which, in conjunction with other factors, are operating as “preference differentials” in attracting skilled manpower from other countries.

TABLE 3

**Latin America: main recipient countries of immigrants of Latin American origin in the professional, technical and related categories, based on 1980s censuses<sup>a</sup>**

	Number	%	As a percentage of human resources in the professional, technical and related categories in the recipient country
Venezuela	25 889	100.0	6.9
Colombians	12 994	50.2	
Chileans	2 894	11.2	
Peruvians	2 367	9.1	
Other	7 634	29.5	
Argentina	18 179	100.0	1.8
Paraguayans	4 698	25.8	
Uruguayans	4 372	24.1	
Chileans	3 629	20.0	
Other	5 480	30.1	
Brazil	11 138	100.0	0.4
Argentines	2 907	26.1	
Chileans	2 217	19.9	
Uruguayans	1 596	14.3	
Other	4 418	39.7	

Source: Jorge Martínez P., *La migración de mano de obra calificada dentro de América Latina*, LC/DEM/G.126, series A, No. 275, Santiago, Chile, CELADE, 1992, October.

<sup>a</sup> Includes the 11 Latin American countries covered by the IMILA Programme which conducted censuses during the relevant period.

This explanation of the migratory phenomenon is incomplete, however, since it does not take into account the influence of expulsive factors. The emigration of large numbers, in absolute terms, of Argentine professionals and technical personnel would appear to confirm the fact that general factors alone cannot account for migration entirely; emigratory pressures within the countries must therefore also be at work.

### 3. Impacts of the migration of skilled manpower

The significance of the migration of skilled manpower also depends upon some of its effects on the countries concerned. By analysing the selectivity of the major migratory flows based on a comparison between the proportion of economically active migrants falling into the professional, technical and related categories and the proportion of skilled personnel in the economically active population of the source or destination country, we can gauge the

TABLE 4

**Latin America: main source countries of emigrants in the professional, technical and related categories going to other countries of the region, based on 1980s censuses<sup>a</sup>**

	Number	%	As a percentage of human resources in the professional, technical and related categories in the source country
Colombia	16 572	100.0	6.1
Venezuela	12 994	78.4	
Ecuador	2 027	12.2	
Panama	428	2.6	
Others	1 123	6.8	
Chile	10 872	100.0	3.9
Argentina	3 629	33.4	
Venezuela	2 894	26.6	
Brazil	2 217	20.4	
Others	2 132	19.6	
Argentina	8 786	100.0	0.9
Brazil	2 907	33.1	
Venezuela	1 775	20.2	
Uruguay	1 250	14.2	
Others	2 854	32.5	

Source: Jorge Martínez P., *La migración de mano de obra calificada dentro de América Latina*, LC/DEM/G.126, series A, No. 275, Santiago, Chile, CELADE, 1992, October.

<sup>a</sup> Includes the 20 Latin American countries covered by the IMILA Programme being executed by CELADE.

relative impact of migratory flows on those countries and express it in terms of a selectivity index for those flows.

Let us first look at the indexes for source countries (emigration). When the proportion of skilled personnel among economically active emigrants is greater than in the EAP of the source country (positive selectivity), then that country will be adversely affected, since the percentage of emigrants in the professional, technical and related categories exceeds the percentage of skilled manpower in the resident EAP. When the proportion of skilled manpower among economically active emigrants is smaller than in the source country's EAP (negative selectivity), then the impact of emigration is less marked, unless the actual number of skilled emigrants is large.

The use of the same index for countries of destination (immigration) denotes the favourable effects on those countries, even in the case of a negative selectivity index -i.e., even when the proportion of skilled personnel among economically active

immigrants is smaller than in the destination country's EAP— because, in the final analysis, the entry of skilled personnel is always advantageous for the recipient country. The only difference between a positive and negative selectivity coefficient for a country on the receiving end of a migratory flow is that with a negative coefficient, when the number of skilled immigrants is small, the favourable effect is less appreciable owing to the larger percentage of semi-skilled or unskilled immigrants.

An analysis of the main intraregional migratory flows around 1980 indicates that the highest positive selectivity coefficients recorded for source countries corresponded to Peruvian emigrants in Argentina and Venezuela, Argentine emigrants in Venezuela and Brazil, Chileans in Brazil and Venezuela, and Bolivians in Brazil (see table 5). These flows would therefore appear to have had a strongly adverse effect on the source countries, since the proportion of skilled human resources in these flows was far higher than in the source countries' EAPS.

In contrast, the Chilean, Bolivian and Paraguayan immigrants in Argentina and the Colombians in Venezuela had negative selectivity coefficients, which means that the adverse effect of these emigratory flows on their source countries was less severe because of the large proportion of less skilled emigrants within them. Nevertheless, since the number of personnel in professional, technical and related categories emigrating from those countries is large, it is useful to compare the percentage of skilled human resources in the emigrant and national labour forces in order to assess the effect of such emigration on the national labour supply.

With respect to immigrants and their impact on the receiving countries, positive selectivity coefficients were recorded for most of the main flows of immigrants, except for Chilean, Bolivian, Paraguayan and Uruguayan immigrants in Argentina and Colombians in Venezuela. All of these flows are instances of migration between neighbouring countries.

Thus, we can see that flows with positive selectivity coefficients for both source and destination countries are in the majority, and these flows have thus had appreciable adverse effects on their source countries and favourable effects on their countries of destination, since these migratory flows contain a significant percentage of personnel who fall into professional, technical and related categories. Furthermore, the positive selectivity coefficients for source

TABLE 5

**Latin America: selectivity of the main migratory flows within the region, around 1980<sup>a b</sup>**

Flow and percentage of emigrants in professional, technical and related categories	Source-country selectivity (%)	Recipient-country selectivity (%)
<b>Argentines</b>		
Brazil (33.1)	151.5	295.2
Venezuela (20.2)	371.4	257.8
<b>Bolivians</b>		
Argentina (48.2)	-29.3	-58.6
Brazil (33.9)	327.6	293.7
<b>Chileans</b>		
Argentina (33.4)	-57.1	-66.7
Brazil (20.4)	254.6	333.3
Venezuela (26.6)	197.4	175.9
<b>Colombians</b>		
Venezuela (78.4)	-17.0	-47.0
<b>Paraguayans</b>		
Argentina (79.9)	-20.9	-65.7
<b>Peruvians</b>		
Argentina (29.8)	407.7	300.0
Venezuela (40.2)	141.0	126.5
<b>Uruguayos</b>		
Argentina (60.7)	22.1	-16.2
Brazil (22.2)	122.1	139.7

Source: Jorge Martínez P., *La migración de mano de obra calificada dentro de América Latina*, LC/DEM/G.126, series A, No. 275, Santiago, Chile, CELADE, 1992, October.

<sup>a</sup> Includes the 11 Latin American countries covered by the IMILA Programme which conducted censuses during the relevant period.

<sup>b</sup> Selectivity is defined as the difference between the percentage of professional, technical and related personnel in the migratory flow and the corresponding percentage in the country of reference, divided by the percentage of professional, technical and related personnel in the country of reference. The result is then multiplied by 100.

countries increase in proportion to their distance from the destination country, but they are not consistently higher for all emigratory flows from a given country.

These indexes, which help to illustrate the significance of the intraregional migration of skilled manpower, are a basic tool for measuring migratory selectivity as one among various factors to be taken into consideration in reviewing the results of selected policies in countries that claim to be promoting selective immigration.

## IV

### The stance adopted by governments and the migration of skilled manpower

In examining the Governments' official attitudes towards international migration, we should remember that such attitudes can be expressed in two different ways. The first, which is found in almost all countries, is the regulation of people's arrivals, departures and their length of stay in a country's territory. The second, less frequent, form of expression is the design of explicit policies on international migration, which include regulations as well as policy objectives such as speeding up or slowing down the rate of population growth, ensuring the settlement of the territory or taking action to influence the supply of manpower in labour markets, depending on the situation in each country.

The types of official responses formulated by Governments provide a basis from which to evaluate their approach to international migration and, within that broader category, the migration of skilled manpower. In Latin America, the predominant official position has been to regulate population movements through legislation drawn up, in most cases, in response to specific circumstances; in other words, legislation that does not take into account the compatibilization of long-term social, economic and demographic objectives. As noted by Torrado some years ago, although such measures may come to form "implicit policies" when objectives are defined in conjunction with them, they are none the less seriously flawed in terms of their effectiveness because they are formulated and implemented without reference to more general sets of objectives (Torrado, 1979, pp. 117-136).

Governments have attributed a great deal of importance to the migration of unskilled manpower in Latin America; this phenomenon involves large contingents of the population and, in some cases, a large percentage of illegal immigrants. A great deal of attention has also been focused on the emigration of skilled manpower to industrialized countries.

The present analysis of the intraregional migratory flows of a particular segment of the labour

force indicates that greater attention should be devoted to the migration of skilled manpower within the region: first, because it has been demonstrated that intraregional migratory flows are not always composed of an overwhelming majority of unskilled or semi-skilled manpower, since the economically active migrants in a number of these flows include a significant percentage of skilled human resources; and second, because the figures on migrants indicate that the quantitative scale of the brain drain represented by an outflow of skilled manpower to the United States is less than that of the intraregional migration of skilled manpower, in which the flows of very large numbers of skilled emigrants from South American countries are directed mainly towards just two or three countries in the region.

In view of the foregoing, it will be useful to analyse the official attitudes adopted by some Governments with regard to the migration of skilled manpower and to see how they tie in with the available information so that specific topics may be identified for further study.

#### 1. Selective immigration and skilled immigrants in selected countries

Policy measures regarding immigration in the countries of the region have been limited to a few cases in which Governments have promoted selective immigration.<sup>4</sup>

<sup>4</sup> Skilled immigrants from developed countries are not taken into consideration here. According to the censuses of the 1980s, for example, a total of 10 000 emigrants from the United States who fell into the professional, technical or related categories were living in 11 Latin American countries, and almost one half of that number was concentrated in Brazil and Venezuela (Martínez, 1992). Viewed in its proper proportions, immigration from outside the region is currently an important issue which should be investigated in the future.

Based on the assumption that policy measures might be more effective than simple regulations, an analysis of the information regarding skilled immigrants in some of those countries may enable us to ascertain the actual effectiveness of such policies while leaving no doubt as to the fact that, in dealing with horizontal migration, consideration should at all times be given to what happens in the home country when it becomes a source of skilled human resources for those countries that are promoting the immigration of such resources.

By the late 1980s, explicit, selective immigration policies had been implemented in Latin America by Argentina (1977), Bolivia (1976), Ecuador (1987), Honduras (1971), Paraguay (1974) and Venezuela (1976); in all these cases, the object was to promote immigration by legislative means within the framework of these countries' overall development objectives. The incentives primarily took the form of requirements that preferential conditions be provided for immigrants based on their skills, the activities they would pursue, their age and available capital (ICM, 1981).

The Governments of the remaining countries of the region have adopted regulatory measures relating to illegal immigrants and labour-market conditions (CIME, 1981) or have participated in the selective immigration programmes of the Intergovernmental Committee for Migration (ICM)<sup>5</sup>, whose aim is to select skilled immigrants, primarily of European origin, and to channel them to requesting countries.

The policies applied by Venezuela and Argentina were shaped by a long-standing legal tradition in this matter. For Argentina, selective immigration policies have a demographic basis (faster population growth) while for Venezuela, where the policy tool of choice would usually take the form of a programme (Pellegrino, 1987), these policies are chiefly a means of addressing the country's needs for certain types of skills. In both countries, however, the focus is on skilled people who can make a contribution to national development.

<sup>5</sup> In November 1989, the Intergovernmental Committee for Migration (ICM) changed its name to the International Organization for Migration (IOM). However, since this article deals with events pre-dating the name change, the Organization's former name and its corresponding acronym (ICM) will be used here.

In the other countries studied, both of these objectives (albeit with some variations) are also at work, since they perceive immigration as providing benefits in the form of supposed improvements in production. In some cases the policies appear to be of a quite general nature and might more accurately be described as governmental declarations of intent than as instruments for implementing policy actions. For example, Ecuador's population policy statement (1987) defines "the need to implement incentives for selective immigration" very broadly and those incentives are not, for the time being, specified (CONADE, 1988).

In view of this interest in selective immigration, with the term being defined in terms of the skills possessed by immigrants, it will be useful to analyse the information on immigrants of Latin American origin in the professional, technical and related categories who are residing in the main receptor countries of the region. Our analysis should therefore cover two different facets of the subject: the impact on the supply of skilled human resources in the source countries, and the effect of immigration on recipient countries. These effects can be identified by determining the selectivity of the corresponding migratory flows and examining the occupational characteristics of skilled immigrants and their position in the labour market.

An exploration of the effects of selective immigration on the domestic supply of skilled human resources in the countries of origin brings to light the existence of substantial impacts which should be taken into account in the study of migratory policies when dealing with movements between developing countries.

As noted earlier, the censuses of the 1980s round indicated that Venezuela and Argentina were the destinations of the greatest number of skilled Latin American immigrants. Table 6 shows that in Venezuela, Colombians –by far the most numerous group– represented nearly 5% and Chileans 1% of their respective home country's supply of skilled manpower. In Argentina, the main flows of immigrants were fairly homogeneous and represented an even larger percentage of their home countries' skilled labour forces. Paraguayans, Uruguayans and Chileans, in that order, were the most numerous, with the number of skilled emigrants representing a substantial percentage of their countries' domestic supply in the case of Paraguay (nearly 11%) and Uruguay (6%); in other words, these countries had transferred many of

TABLE 6

**Venezuela and Argentina: main flows of Latin American immigrants, broken down by selected occupational and educational characteristics and as compared to the same characteristics as present in the country of birth, around 1980**

Country of birth	Immigrants		Immigrants as a percentage of national labour	
	Professionals, technicians and related personnel	10 years of schooling or more	Professionals, technicians and related personnel	10 years of schooling or more
		Venezuela		
Argentina	1 775	5 536	0.6	...
Chile	2 894	11 553	1.0	0.6
Colombia	12 944	60 516	4.8	7.4
Peru	2 367	11 256	0.6	1.0
		Argentina		
Bolivia	2 602	14 558	3.0	3.8
Chile	3 629	28 338	1.3	1.5
Paraguay	4 698	28 284	10.6	12.4
Uruguay	4 372	30 659	6.0	5.9

Source: Jorge Martínez P., *La migración de mano de obra calificada dentro de América Latina*, LC/DEM/G.126, series A, No. 275, Santiago, Chile, CELADE, 1992, October.

their professional, technical and related human resources to Argentina. This same table also provides information on the proportion of the population having 10 or more years of schooling, since the behaviour of this segment is to some extent correlated with that of skilled human resources.

The foregoing confirms the advisability of incorporating these aspects into the examination of any migration policy, inasmuch as the promotion of selective immigration could have undesirable implications for other countries of the region. Indeed, even though the results of a country's policy cannot be measured directly using the general sort of data being discussed here, it is clear that migratory policies could be a significant ancillary factor when their influence is added to the more general types of factors that prompt the migration of skilled manpower.

The effect of immigration on recipient countries depends upon the type of selectivity characterizing overall migratory flows. As stated earlier, in Venezuela and, especially, Argentina, the flows coming from neighbouring countries exhibit negative selectivity; this means that they include a large percentage of semi-skilled and unskilled labour, and the countries of destination therefore receive a more limited number of skilled human resources.

If we now look at the occupational characteristics of skilled immigrants by considering the

different categories of professionals received by countries of destination in the region, we see that the predominant group among the skilled immigrants present in Venezuela and Argentina around 1980 (see table 7) were "teachers and other", which represented about one third and one half of the total, respectively. This group was composed chiefly of Colombians and Chileans in the case of Venezuela and of Uruguayans, Paraguayans and Chileans in Argentina.

The breakdown of the remaining professional categories in these two countries differed greatly from one another. In Venezuela, the remaining skilled Latin American immigrants were principally "architects, engineers and related occupations", most of whom were Colombians, Chileans and Peruvians (this was partly due to aggressive recruiting programmes carried out in Chile and Peru) (Pellegrino, 1986) and "writers, artists and related occupations", among whom Colombians, Argentines and Chileans were the most numerous nationalities; the large size of this latter occupational group would appear to place Venezuela in a particularly strong position for the development of cultural activities. In Argentina, the other half of the population of skilled immigrants was composed chiefly of "nurses, midwives and related occupations", most of whom were Paraguayans and Chileans, and "doctors, dentists and related

TABLE 7

**Argentina, Brazil, Venezuela: Latin American immigrants  
present around 1980, by occupational category<sup>a</sup>**

Occupational category	Country of immigration					
	Argentina 1980		Brazil 1980		Venezuela 1981	
	Number	%	Number	%	Number	%
Architects, engineers and related occupations	495	2.7	3 405	30.5	6 666	25.8
Chemists, physicists and related occupations	...	...	431	3.9	243	0.9
Biologists, agronomists and related occupations	...	...	298	2.7	287	1.1
Doctors, dentists and related occupations	2 575	14.2	1 732	15.5	1 743	6.7
Paramedics and related occupations	...	...	213	1.9	574	2.2
Nurses, midwives and related occupations	4 179	23.0	454	4.1	2 142	8.3
Mathematicians, statisticians and related occupations	595	3.3	1 061	9.5	528	2.0
Lawyers and related occupations	362	2.0	1 820	16.3	947	3.7
Writers, artists and related occupations	...	...	1 385	12.4	3 035	11.7
Church personnel and related occupations	...	...	174	1.6	371	1.4
Teachers and other	9 973	54.9	184	1.7	9 353	36.1
<b>Total</b>	<b>18 179</b>	<b>100.0</b>	<b>11 157</b>	<b>100.0</b>	<b>25 889</b>	<b>100.0</b>

Source: Jorge Martínez P., *La migración de mano de obra calificada dentro de América Latina*, LC/DEM/G.126, series A, No. 275, Santiago, Chile, CELADE, 1992, October.

<sup>a</sup> Includes 10 countries of origin for Argentina and 19 for Brazil and Venezuela.

occupations”, with Peruvians and Paraguayans being the most numerous practitioners.

If we divide the professional categories into two groups based on their skill levels (advanced and intermediate),<sup>6</sup> significant differences emerge: slightly less than 22% of skilled immigrants in Argentina were in the advanced skill-levels category, whereas in Venezuela nearly 52% were (with Colombians being in the majority). In Brazil—which is also a destination, albeit a slightly less popular one, for immigrants within the region—the figure for this category was 91% and was composed primarily of Chileans and Argentines.

This information on the occupational characteristics of skilled immigrants indicates that a large share of these immigrants fall into the “teachers and

other” category in Venezuela and Argentina, but that this is not the case in Brazil. In view of this situation, it is of interest to recall that in promoting selective immigration (including, of course, selective intraregional immigration), what the Governments are trying to do is to attract scarce, preferably very high-level, human resources who may then be channeled into crucial sectors of their economies.

An examination of skilled immigrants’ positions within the labour force can be expected to illustrate the attraction exerted by recipient countries and, in particular, to tell us whether the resources those countries manage to attract are the types of resources they need for pivotal sectors of their economies.

In the three countries in question, skilled personnel are concentrated in the services (social and financial) sectors, and the main flows of immigrants continue to conform fairly closely to that pattern (Martínez, 1992). Thus, the immigrants’ positions within the labour force, broken down by area of economic activity, do not provide us with a great deal of information about the factors that attract those immigrants, and it will therefore be necessary to look for their reasons in the general types of conditions that are conducive to certain specialized occupations, specifically in the educational and health sectors.

<sup>6</sup> The advanced skill-level category includes: architects, engineers and related occupations; chemists, physicists and related occupations; biologists, agronomists and related occupations; doctors, dentists and related occupations; mathematicians, statisticians and related occupations; lawyers and related occupations; and writers, artists and related occupations. The intermediate skill-level category includes: paramedics and related occupations; nurses, midwives and related occupations; church personnel and related occupations; and teachers and other.

Since services are not a sector that can be regarded as of decisive importance (regardless of how valuable the individual contributions made by skilled immigrants working in that sector may be), the next step is to ascertain the relative significance of other sectors, such as manufacturing. In this connection, Argentina displays the least concentration of skilled personnel in the services sector and a fairly significant number of such personnel in the manufacturing and construction sectors. In Venezuela, the concentration of immigrants in the services sector is more marked, although the percentage of skilled immigrants in manufacturing is also considerable. Brazil is the country with the greatest concentration of skilled human resources in services and manufacturing (Martínez, 1992).

These figures bear a relation to the traits of the immigrants concerned. In Venezuela, for example, slightly over one-half of skilled immigrants fall into the advanced skill-level category, which would appear to account for their presence in the services and, to a lesser extent, manufacturing sectors. In Brazil, skilled immigrants are concentrated only in services and manufacturing, and the majority of them are in the advanced skill-level category.

Consequently, a higher skill level among immigrants appears to be associated with a higher percentage of immigrants in the services and manufacturing sectors. However, the fact that the percentage of immigrants in manufacturing usually comes in second place, despite this sector's strategic importance for the economy of the recipient country, indicates that the distribution of skilled immigrants among the various branches of economic activity does not necessarily correspond to the objectives pursued through the promotion of selective immigration. Moreover, in the case of Brazil, no explicit incentives have been provided but immigrants nevertheless exhibit a higher skill level and are more strongly oriented towards manufacturing.

In sum, migration among developing countries may have undesirable effects in terms of the supply of skilled human resources in the migrants' home countries. In addition, in cases where the immigrants come mainly from neighbouring countries, it is highly probable that the migratory flows towards countries within the region having a relatively higher level of development will exhibit negative selectivity in relation both to source and destination countries, which may obscure the actual extent of migration by skilled manpower. These two effects, measured in

relative terms, are general aspects that should be taken into account by selective immigration policies in any case where large numbers of migrants are concerned.

With regard to the occupational characteristics of skilled immigrants and their positions within the labour force, these variables are probably linked to the relatively higher level of development of some economic activities in the recipient country which create a demand for certain specializations, particularly in the services sector. Thus we can make the statement that, within the bounds of their freedom of action, selective immigration policies aimed primarily at attracting skilled human resources are successful when they result in a preponderance of highly-skilled immigrants and when these immigrants find their way into economic sectors of strategic importance to the recipient country.

All this points to the advisability of taking a closer look at the various countries' situations, both in order to ascertain how viable and effective immigration policies truly are in achieving their objectives and in order to apply such policies in a suitable way in other countries that have a shortage of skilled human resources in many sectors.

## **2. The emigration of skilled manpower and skilled emigrants in selected countries**

Just as we have done in the case of immigration, reviewing some of the Governments' responses to emigration is a first step in evaluating what has been done in this regard. In many Latin American countries, the emigration of skilled manpower has prompted the issuance of regulations intended to form what might be characterized as an "implicit" policy. Despite justified concerns—mainly, it appears, about the problem of the brain drain and the lack of any form of compensation for source countries—however, this form of governmental response has not managed to move beyond the legislative bounds of such measures in order to address the overarching issue of emigration in the region.

An evaluation of the options appears to be a very complicated task, given the vast number of measures—and possible policies—that have to be considered, including the immigration policies of recipient countries. Basically, however, among all the different measures proposed in developing countries, the Latin American Governments have focused on means of retention (restrictions on the emigration of

professionals and technical personnel) and of return or repatriation (with the help of various sorts of programmes).

With regard to efforts at retention, the imposition of restrictions on the emigration of professionals and technicians has been controversial because such restrictions have generally taken the form of mechanisms for hindering such individuals from leaving the country. They do not address the factors that lead to emigration; they may infringe upon the individual's right to unhampered international mobility for purposes of intellectual work; and they are usually easy to evade, which renders them ineffective. The case of Haiti, where measures of retention were used in the 1970s, backs up these objections, inasmuch as during that period, up to around 1980, the number of professionals and technically-trained personnel who left the country actually increased (Martínez, 1992).

The most common sorts of mechanisms of retention used up until a few years ago were a refusal to issue or renew passports, special fees or charges for the issuance of an exit visa, foreign exchange controls, and other such measures. Many Latin American countries implemented such restrictions because of the perceived problem of the brain drain towards industrialized countries (Torrado, 1979, pp. 117-136).

If this was actually the main reason why Governments sought to justify and direct measures of retention, then they clearly had a mistaken impression of the usefulness of this type of measure, given the fact that a number of Latin American countries' skilled emigrants are concentrated—in some cases very markedly—in other countries within the region itself.

The return of skilled emigrants, for its part, is an underlying concern for countries that have re-established a democratic institutional structure as well as for countries that for some time now have simply seen their return as a viable option for counteracting the consequences of the emigration of professional, technical and related personnel. There are two types of procedures in this respect: the implementation of programmes and measures by some Governments of the region, and the implementation of ICM institutional programmes at the request of the Government concerned.

Programmes and measures designed to bring emigrants back to their home country, including those who left for political reasons, have been used much more frequently in Latin America than

measures of retention because they at least appear to be less complex and to have a lower economic cost (Torrado, 1982). Few of such programmes have gone beyond simply providing exemptions from customs or other duties, however, and they have therefore been largely ineffective. This signifies that "desirability" has been the main criterion for many countries in the region. The basic problem here is that these government responses have not actually constituted full-fledged policies, although they have sometimes been presented as such, but are instead simply measures or programmes largely unrelated to broader social and economic objectives. The above also underscores the fallacy of assuming that designing a policy aimed at securing emigrants' return is less complicated than designing a policy of retention, since a return to the home country is part of the migratory process.

The Programme for the Return of Professionals and Technicians in Colombia, which has been one of the Latin American countries to be most severely affected by emigration, is a good example in this regard. The programme, implemented in 1972, was chiefly aimed at professionals residing in industrialized countries; in addition to customs, tax and administrative incentives or concessions for the importation of basic goods, one of its main features was a provision regarding the rendering of services in the home country without a labour contract being required (as a means of providing returning emigrants with greater freedom in finding employment) and a requirement that they remain in the country for at least five years after returning (CID, 1981). An evaluation of this programme arrived at the conclusion that it had been a failure, according to the parties concerned, owing to the lack of protection afforded to returning emigrants with regard to conditions of employment, the insufficient information provided regarding employment and wages, and the fact that the requirement of a minimum length of stay in the country was regarded as an arbitrary measure.

Another useful example is the return of skilled emigrants to Uruguay with the help of the international community and various public and private organizations. In view of the unsatisfactory results achieved in this respect as of the late 1980s (even though the number of returnees was rising), the belief took hold that it had become necessary to place the subject within the context of an effort to mend the social fabric of Uruguayan society, which was in disarray; thus the repatriation of emigrants came to be

seen as an economically and socially viable form of social, rather than solely material, re-integration (Fortuna and Niedworok, 1988, pp. 27-122).

In terms of official government action, the repatriation of emigrants is an important element in the analysis of policies relating to emigration. It is therefore essential that a broad-ranging debate take place that can contribute to the achievement of the ultimate objective, which is the recovery of people who are valuable from a social standpoint and expensive from an economic one. Nor should we forget that the issue of returning emigrants also encompasses less skilled individuals and entire families.

At the request of its member Governments, ICM launched a series of institutional programmes in 1974 to facilitate the voluntary return of skilled Latin Americans who were living outside their home countries but who chose to return as part of what was seen as a repatriation of "talent" (ICM, 1986). As part of these programmes, which focus mainly on the return of emigrants residing outside the region, employment opportunities have been identified that cannot be filled by the human resources on hand in the Latin American countries but whose requirements could be met by professionals of the same nationality residing abroad.

ICM sought to recruit those who were willing to return to their home country by mounting campaigns to disseminate information about local job opportunities, living and work conditions, and customs laws. It also made the necessary arrangements itself, helping with the actual move back to the country and welcoming the returnees upon arrival, helping them to get settled and providing assistance during the adaptation phase. By the end of the 1980s, 1 126 professionals had returned under these programmes, almost all of whom came from outside the region; a particularly large proportion were Chileans returning to their country (CID, 1981).

The nature of this process suggests that little attention was paid to potential returnees residing in other Latin American countries at the time, even though, for countries such as Bolivia, Chile, Paraguay or Uruguay, this description fits the majority of their skilled emigrants. Obviously, assuming that a significant percentage of such emigrants wished to return to their home country, it would make sense to devote attention to this segment of the emigrant population.

The above-mentioned elements indicate the absence of explicit policies on emigration in Latin America, at least until a few years ago. Measures of retention have been controversial, highly ineffective and seem to have overlooked the intraregional emigration of professionals and technicians. A similar degree of ineffectiveness has characterized repatriation programmes. All these facts underscore the presence of serious shortcomings in respect of migration policies addressing the problem of the emigration of skilled manpower.

What has been said here about selective immigration and the emigration of professionals and technicians illustrates just how complex a task it is for developing countries to formulate and implement policies regarding the migration of skilled human resources. However, this does not justify simply neglecting to search for effective courses of action appropriate to each particular situation based on a prior understanding of the contexts in which they will have to be pursued (Torrado, 1982). It is very important that a comprehensive baseline analysis be conducted; the information referred to in the above discussion, as well as some of the interesting features of emigratory flows that will be mentioned below, may contribute to that analysis.

For example, skilled emigrants from Argentina, Chile and Uruguay together accounted for around one third of all intraregional emigrants around 1980. During that period the emigrants from these countries, especially in the case of the Chileans and Uruguayans, were concentrated within the region, whereas around 1970 only the latter had been.

Between 1970 and 1980, emigratory flows from these three countries, both those within the region and those directed towards the United States, expanded considerably. The increase in the intraregional flow was substantially greater, however, and was particularly marked in the case of Argentine and Chilean emigrants, whose numbers nearly quadrupled (Martínez, 1992).

These facts appear to indicate that repatriation programmes, customs exemptions and the ICM arrangements (certainly in Argentina and Chile) did not yield satisfactory results, although the percentage of political refugees who had to emigrate in the 1970s, especially from Argentina and Chile, is unknown.

Table 8 shows that the main flows of Chilean and Uruguayan emigrants had a number of destinations

TABLE 8

**Argentina, Chile, Uruguay: emigrants in the  
professional, technical and related categories present  
in Latin America around 1980<sup>a</sup>**

Country of residence and year	Country of birth					
	Argentina		Chile		Uruguay	
	Number	%	Number	%	Number	%
Argentina 1980			3 629	33.4	4 372	60.7
Bolivia 1976	454	5.2	501	4.6	19	0.3
Brazil 1980	2 907	33.1	2 217	20.4	1 596	22.1
Chile 1982	797	9.1			133	1.9
Costa Rica 1984	142	1.6	267	2.5	36	0.5
Ecuador 1984	328	3.7	912	8.4	80	1.1
Guatemala 1981	44	0.5	56	0.5	10	0.1
Panama 1980	82	0.9	152	1.4	14	0.2
Paraguay 1982	1 007	11.5	143	1.3	202	2.8
Uruguay 1975	1 250	14.2	101	0.9		
Venezuela 1981	1 775	20.2	2 894	26.6	740	10.3
<b>Total</b>	<b>8 786</b>	<b>100.0</b>	<b>10 872</b>	<b>100.0</b>	<b>7 202</b>	<b>100.0</b>

Source: Jorge Martínez P., *La migración de mano de obra calificada dentro de América Latina*, LC/DEM/G.126, series A, No. 275, Santiago, Chile, CELADE, 1992, October.

<sup>a</sup> Includes the 11 Latin American countries covered by the IMILA Programme which conducted censuses during the relevant period.

in common. The greatest concentration of Chileans, by a slight margin, was found in Argentina, but many went to Venezuela and Brazil as well. Over one half of the Uruguayans settled in Argentina. The largest contingent of Argentines, for their part, headed for Brazil, and many others went to Venezuela.

If we examine certain features of these flows of emigrants, a number of significant aspects emerge. For example, 19% of all economically active Argentine emigrants were skilled, but this group represented only 1% of its country's stock of skilled manpower. In contrast, in Uruguay the latter figure was 10% (Martínez, 1992). Thus, although both countries exhibit a markedly positive selectivity in respect of their emigrants, the intraregional emigration of skilled human resources affected the two countries' national supplies of such resources very differently.

The intraregional emigration of Chileans, on the other hand, exhibited a low level of positive selectivity due, no doubt, to the large number of semi-skilled and unskilled workers who emigrate to Argentina; nevertheless, it had a fairly strong impact (nearly 4%) on the national stock of skilled resources (Martínez, 1992).

An analysis of the distribution of emigrants by skill levels brings out other differences as well. Human resources in the more highly skilled categories were in the majority only among Argentines (nearly 66%), with the largest category being "architects, engineers and related occupations"; this denotes a qualitatively significant emigratory flow, which was directed primarily towards Brazil and Venezuela. Among the Chileans and Uruguayans, the majority of skilled emigrants fell into intermediate skill categories, the most numerous one being "teachers and other" (Martínez, 1992).

The foregoing information, although very general in nature, demonstrates the need to devote priority attention to the emigration of skilled manpower, especially in view of the fact that the flow of skilled personnel to the United States has continued, that, at least until the early 1980s, the phenomenon has been of increasing significance at the intraregional level, and that it may have a considerable impact on countries whose professional and technically-trained emigrants represent a substantial proportion of the national stock of such resources.

# V

## Conclusions

In this article an attempt has been made to demonstrate the significance of the international migration of skilled manpower between developing countries as illustrated by the case of Latin America. Some of the many relevant aspects of this phenomenon are set out below.

The migration of skilled manpower constitutes a problem for developing countries; this is especially true of emigration, regardless of the country of destination. It is therefore necessary to learn more about the causes and consequences of migratory movements, not only in the case of those directed towards the industrialized world, but also with respect to flows between developing countries (horizontal migration).

As is true of migration in general, the migration of skilled human resources between developing countries is prompted by factors of both attraction and expulsion. Its undesirable consequences, without delving too deeply into this aspect, are basically the loss of investment and of production resources; the specific nature of these losses can only be ascertained by means of case studies. The central argument in corroborating the existence of such losses is that, for developing countries, the full utilization of each nation's skilled human resources is essential to the promotion of the social and economic well-being of the population.

The pattern of migratory flows of skilled human resources within Latin America indicates that, both in the early 1970s and around 1980, a considerable portion of the skilled emigrants coming from a number of countries were concentrated in a few countries of destination. This means that some countries were transferring ("paying out") numerous professionals and a large percentage of their national stock of skilled resources to other countries. This is a significant aspect of the issue that should be explored in depth.

If we compare various Governments' reactions to some of the problems brought out by this analysis of migratory flows, on the one hand, with actual observations of the situation, on the other, a number of questions arise. The main migratory flows towards

countries that promote what has come to be known as "selective immigration" come from neighbouring countries and have an impact on the home countries' stock of skilled human resources. This has some undesired effects and generates a negative selectivity in these flows that appears to remain constant in the case of migration between neighbouring countries. Furthermore, a preponderance of highly skilled immigrants specialized in the fields vital to the receiving economy, which is the goal of such policies, has not been observed. All of this suggests that the objectives of selective immigration policies need to be realistically geared to the characteristics of each country's development process.

It is interesting to note that almost all the Governments have taken a quite favourable view of the immigration of skilled resources but that few countries have formulated and applied explicit policies in this regard.

The emigration of skilled manpower is a particular cause of concern. Given the fact that the migration of this segment of the labour force—to the United States and, especially, within the region—increased sharply between 1970 and 1980, government measures in this connection do not appear to have been very effective, above all because the Governments have not managed to design policies that are firmly based on a full understanding of the problems they seek to address.

One particularly salient aspect that emerges out of a country-by-country analysis of migratory flows is the quantitative scale of the intraregional emigration of skilled manpower as compared to that of Latin American emigration to the United States. This is a highly significant finding, especially with respect to the years around 1970, because, beginning with that high point in the debate surrounding the problem of the brain drain, this phenomenon came to be perceived primarily as one involving the emigration of Latin American professionals and technicians to the United States. This does not, of course, mean that this will inevitably be the trend of the future nor that the same pattern necessarily characterized the 1980s.

The foregoing observations are presented solely with the intention of addressing the subject and calling for detailed, current research on specific situations based on adequate empirical evidence. In view of its significance, the international migra-

tion of skilled manpower within Latin America merits a more in-depth analysis designed, above all, to contribute to the implementation of appropriate policies.

(Original: Spanish)

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# Social sciences *and social reality* in Central America

*"Familiarity is the  
opium of the imagination"*  
Arnold Toynbee

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The poverty and weakness of Central America, combined with its potential strategic importance in world politics, have made this region extremely vulnerable to external intellectual and political influences. The result of these influences has been national political processes guided by European notions of Conservatism, Liberalism and Socialism, and a social sciences tradition that is trapped in the intellectual ethos of its mid-nineteenth century European precursors. This article argues that the Eurocentric theoretical orientation dominating Central American social sciences ignores the fact that the relation between time and space that conditioned the evolution of Europe is qualitatively different from that which has influenced the political evolution of Central America since 1492. Different time/space relations have produced different kinds of States as well as different political actors and institutions. The main challenge faced by the Central American social sciences today is to identify these differences and to study and treat them as Central American normalities, rather than as deviations from pre-established European patterns.

# I

## Introduction

The formal political history of Latin America has been, to a large extent, a coarse imitation of European political history. Social designs and projects for the organization of political life in this vast region of the world have been predominantly formulated and rationalized on the basis of political values, ideas and practices that originated in Europe (Davis, 1963, p. 2; Zea, 1963; Salazar Bondy, 1968). During the eighteenth century, the ideas of the Enlightenment fired the imagination of the *Criollos* and supplied them with an intellectual foundation to legitimize their pro-independence movement. In the nineteenth century, positivism provided the national elites of Latin American countries with a prescription for "order and progress", while in the twentieth century democracy became either an argument for the preservation of social order, or a reason to subvert the existing one. After the Bolshevik Revolution, socialism was transformed into a cure for all social ills. More recently, neo-conservatism has become the ideology with which the Latin American elites prepare themselves for the twenty-first century.

Latin American philosophy and social sciences have also imitated their European counterparts. Writing in 1944, Risieri Frondizi pointed out that "the so-called Latin American philosophy is nothing more than the reformulation of philosophical problems originated in Europe. Hence, to be concerned about its history is to deal with the influence that European philosophy had on it" (Frondizi, 1944, p. 95). In an analysis of the current situation of Latin American philosophy, Jorge J. E. Gracia argues that thanks to the work of philosophers such as Leopoldo Zea, Eduardo García Maynez, Juan Llambras de Azevedo, Jorge Millas, Francisco Miró Quesada and Frondizi himself, Latin American philosophy has gone beyond the stage of "uncritical absorption" and is moving "from a period of critical interaction into a period of maturity" (Gracia, 1988-1989, pp. 4-5). However, Gracia points out, Latin American philosophy "still moves to a large extent due to external stimuli: it reacts instead of acting by itself. The changes that take place in it periodically are still largely the result of the impact that European

and North American ideas have on our philosophers" (Gracia, 1988-89, p. 4).<sup>1</sup>

Moreover, sociology, political science, economics and anthropology have also followed a Eurocentric perspective; that is, they have developed a theoretical orientation that is "based on the narrow and rather particular experience of Western Europe (actually a much smaller nucleus of countries in central and north-west Europe) and the United States..." (Wiarda, 1990, p. 396). Ever since their inception in the post-World War II period, the Latin American social sciences have been reluctant to explore the distinct nature of the region's history after 1492, the year when Colon's arrival created a time bridge that connected the newly-discovered continent with Europe's past.<sup>2</sup> The history of Europe and the values, ideas and principles emerging from that history became the background against which the emerging Latin America would define its basic notions and conceptions about politics, economics and society for the next five hundred years (Wolf, 1982).

Few regions of the continent show the imitative nature of both Latin American politics and social sciences as clearly as Central America.<sup>3</sup> The size, fragmentation and weakness of the Isthmus, combined with its potential strategic importance in world politics, have made Central America extremely vulnerable to external intellectual and political influences. The result of these influences has been national political processes guided by European notions of Conservatism, Liberalism and Socialism, and a social sciences tradition that is trapped in the intellectual ethos of its mid-nineteenth century European precursors.

<sup>1</sup> For a recent review of Latin American philosophy, see Donoso, 1992.

<sup>2</sup> I agree with Kahl that social sciences emerged in Latin America only after World War II (Kahl, 1976, p. 1). For a review of Latin American social thought before World War II see Davis, 1963.

<sup>3</sup> The practice of philosophy in Central America is very limited. For a review of the current situation in the region see Gracia, 1989.

This paper argues that the Eurocentric theoretical orientation dominating Central American social sciences ignores the fact that the relation between time and space that conditioned the evolution of Europe is qualitatively different from that which influenced the political evolution of Central America since 1492. Different time-space relations have produced different kinds of States as well as different political actors and institutions. The main challenge faced by the Central American social sciences today is to identify these differences and to study and treat them as Central American normalities, rather than as deviations from pre-established European patterns.

Part II of this paper outlines the relationship between the development of social sciences and the spatial-temporal dimension of European politics. The imitative and Eurocentric character of Central American social sciences, and the incongruence between social theory and social reality in Central America, are discussed in part III. Part IV contains the outline of a proposal for closing the gap between social theory and social practice in the region. This outline is based on Charles Taylor's work on interpretation and the human sciences. Finally, part V summarizes the main arguments of the paper and presents some tentative conclusions.

## II

### Social sciences and the spatial and temporal dimension of politics in Europe

The State, both as a concept and a political phenomenon, "contains" the historical experience associated with the organization of the territorial, social, political, cultural and economic life of the Western world over the last four hundred years. In this sense, the State is "constitutive of political reality" (Vincent, 1987, p. 224). Different views regarding the nature of the State represent different interpretations of the most essential institutional development of Western social life. Not surprisingly, the State has been the centre of controversy throughout the development of the social sciences in Europe. Class-based, elitist, and pluralist interpretations of the State compete with each other in terms of their explanatory power. All of them, however, assume the existence and centrality of a sovereign territorial and symbolic arena within which conflict over the distribution of economic and political power takes place according to legal rules and regulations that are enforced and institutionalized by bureaucratic machinery.

The emergence of modern States transformed politics into a struggle over the distribution of power within the boundaries of legally established sovereign territories. It is no accident, then, that there is a close relationship between the development and consolidation of the theory and practice of national sovereignty during the seventeenth and eighteenth centuries and that of democracy (Beloff, 1962,

pp. 170-182; Hinsley, 1986, pp. 158-235). Reinhold Niebuhr has noted that modern democratic theories "almost without exception assume the autonomy of the national State" (Niebuhr, 1959, p. 64). F. H. Hinsley corroborates this view when he explains that:

"The rise of legislatures, the introduction of representation, the extension of suffrage and the insertion of constitutional features into the basis, the composition and the procedures of government necessitated the notion that sovereignty resided in the body politic as a means of preserving the precondition of effective action in and for the community" (Hinsley, 1986, p. 223).

The emergence of the modern concept of sovereignty is linked historically to the decline of both the Roman Empire and, later, the universal authority of the Catholic Church in Europe. Originally the concept was articulated to legitimize the concentration of "absolute" power and authority in the hands of a sovereign king. This concept evolved later "into the closer association of the developing State and the developing community, which became inevitable when it was discovered that power had to be shared between them" (Hinsley, 1986, p. 222). Therefore, the political systems of the liberal democratic societies of Europe have been the result of an historical struggle over the definition and interpretation of the concept of sovereignty. This process can be

mentally pictured as a series of concentric circles expanding from a central point which represents the scope of sovereignty *in natu nascendi*. Each circle symbolizes a re-conceptualization of the principle of sovereignty and the articulation of a new consensus among domestic power contenders with regard to political rights and the rules that govern political participation and competition. From this perspective, sovereignty is the foundation of political order at the national level. It is the "legal container" in which the turbulence of domestic political competition is balanced through the imposition of limits to both the institutional form and the substance of political competition. The most important of these limitations is that political struggles must take place within the legal and physical boundaries of the State, and with the resources available within these boundaries. Sovereignty, in this sense, does not simply regulate relations among States, but also conditions the competition for power within them, by establishing legal and territorial limits on the resources available to domestic power contenders. From this perspective, the political history of a sovereign State is, to a large extent, locally determined and the future is assumed to be an extrapolation of a geographically and temporally bound present.

The emergence of sovereign States represented the spatial expression of historical time. Time was expressed in space; the physical and legal boundaries of the State served as "containers" of a historical past, a present and, presumably, a future. Thus, sovereign States became "political spaces", that is, geographical areas "where the plans, ambitions and actions of individuals and groups incessantly jarred against each other—colliding, blocking, coalescing, separating..." (Wolin, 1960, p. 60). Sovereignty allowed territories to contain the main determinants and accumulated consequences of their political evolution within legal and geographical boundaries. As such, it came to represent what Gross calls the "specialization of time and experience", which implies "the tendency to condense time relations—which are an essential ingredient for personal and social meaning—into space relations" (Gross, 1981-82, p. 59).

Specialization created the conditions for the emergence and consolidation of national political histories, with national political actors and institutions. In Europe, this political history evolved around the

expansion of citizenship and the challenge it represented to national class structures (Gross, 1985, p. 93). Both class and citizenship constitute evolving historical realities associated with the struggle over the distribution of power within sovereign States. In this sense, the concept of class has a relative meaning *vis-à-vis* citizenship and, conversely, citizenship is a category which has an explanatory value that is intimately linked with that of class. From this perspective, the democratic political history and institutions of the West are the result of the conflictive relationship between these two principles. This conflictive relationship produced civil rights (liberty, freedom of speech, equality before the law, and the right to property ownership) in the eighteenth century; political rights (political participation through universal manhood suffrage) in the nineteenth century; and social rights (welfare, security and education) in the twentieth century (Lipset, 1977).

The actors involved in the struggle for the definition of citizenship and democracy had to justify their social desires and preferences. In so doing, they self-described their roles as actors and articulated explanations that served as the moral foundation for the adoption of specific political institutional arrangements. The relationship between these "self-descriptions" and explanations on the one hand, and the production of social theory on the other, is an intimate one. Charles Taylor points out that "the practices which make up a society require certain self-descriptions on the part of its participants" (Taylor, 1983a, p. 3). The understandings articulated in such self-descriptions "can be called pre-theoretical, not in the sense that they are necessarily uninfluenced by theory, but in that they do not rely on theory" (Taylor, 1983a, pp. 3-4). From this perspective, social theory is made "when we try to formulate explicitly what we are doing, describe the activity which is central to a practice, and articulate the norms which are essential to it" (Taylor, 1983a, p. 4). A theory is, then, "the making explicit of a society's life, i.e., a set of institutions and practices" (Taylor, 1983a, p. 11).

Western social sciences have made explicit the self-descriptions and explanations articulated by the actors involved in the historical development of Western societies. From this perspective, they are the intellectual offspring of the history of the West. They emerged as an intellectual response to the historical conditions of nineteenth-century Europe, and more

specifically to the need for social order in the aftermath of the French and the Industrial Revolutions (Bottomore, 1983, p. 40). The roots of Western social sciences, however, extend beyond the immediate historical circumstances that led to the birth of those fields of study. In fact, their metatheoretical foundations are contained in the production of at least three hundred years of political theory. Comte's view of society derived from philosophy, and he conceived of sociology as a philosophic movement (Martindale, 1960, p. 17). His intellectual enterprise, then, was a continuation of the search for explanations and answers to European historical developments that has preoccupied the minds of Western thinkers for centuries; however, his contribution represented a departure from the prevailing philosophical tradition. His was a "positive" philosophy that differed from the "metaphysical" enterprise of conventional political thinkers of his time (Giddens, 1978, p. 246). Regardless of these differences, Western philosophy and Comte's sociology should be regarded as part of a continuous intellectual effort to make explicit the institutions and practices of Western societies, in particular the phenomenon of the sovereign State and the political practices and institutions engendered by it.

Western social sciences have recently been challenged to re-conceptualize the time-space relations that inform modern social analysis (Wallerstein, 1984 and 1991; Adam, 1990, p. 13). Most notably, Anthony Giddens has argued that these interpretations do not take into consideration the changes in the relationship between time and space that have been brought about by the globalization of modernity. This process is defined by Giddens as "the intensification of worldwide social relations which link distant localities in such a way that local happenings are shaded by events occurring many miles away and vice versa" (Giddens, 1990, p. 64). Globalization destroyed the correspondence between time and space that modern social sciences have taken for granted, and invalidated the notion of sovereignty as the enclosing of political phenomena

within geographical boundaries that contain a national history. According to Giddens, globalization brought about the "disembedding of the social system". By this he refers to "the 'lifting out' of social relations from local contexts of interaction and their restructuring across indefinite spans of time space" (Giddens, 1990, p. 21). Globalization, in other words, penetrated the walls of the sovereign States, linking domestic political processes with international forces. The result of this penetration is the end of politics as a domestic activity and the restructuring of national and political processes at a supranational level (Luard, 1990).

Giddens's criticism of social sciences is relevant to the re-conceptualization of the State, not only in the West but also in developing countries. However, it is important to keep in mind that globalization is a force that runs counter to the resilience and variety of the human condition. The capitalist mode of production, as Eric R. Wolf points out, "may be dominant within the system of capitalist market relations, but it does not transform all the people of the world into industrial producers of surplus value" (Wolf, 1982, p. 297). Therefore, the adoption by social scientists of a "global level of analysis" could be damaging if it ignores the internal specifics of peripheral societies (Slater, 1989, p. 20). Moreover, globalization has a differential political effect on developed and developing countries. Western developed countries carry with them a "reservoir" of political sovereignty that they began to accumulate in the seventeenth century. This created the conditions for the patterns of political conflicts and institutions which resulted in the liberal democratic tradition that we know today. The radicalization of modernity may have reduced this reservoir, but has not exhausted it. Furthermore, these countries located at the centre of the world economy have found ways of protecting their political autonomy by exerting their influences in the international forums constituting the organizational infrastructure of the world system (Faletto, 1989).

### III

## Social sciences and social reality in Central America

The Central American social sciences have perpetuated and legitimized the use of European history as the proper foundation for the analysis of Central American social reality. Concepts, models and theories that evolved out of the European historical experience have become the lenses through which Central Americans try to understand their social existence (Stone, 1990, pp. 145-146). It is not surprising, then, that the academic fashions that have swept Oxford and Princeton are the same as those that have captured the minds of scholars in the universities of the region. As in Europe and North America, the central point of contention in the academic circles of Central America has been that which emerged out of the confrontation between Marxist and "bourgeois" social theories.

The social sciences proper emerged in Central America in the 1970s (Camacho, 1985, p. 1; Lungo Ucles, 1985, p. 4; Torres-Rivas, 1989, p. 5). Prior to that decade, social analysis was carried out by "amateur essayists or *pensadores* who were trained and supported as lawyers and bureaucrats" (Kahl, 1976, p. 1; Torres-Rivas, 1990, pp. 18-19).<sup>4</sup> Three main intellectual approaches can be identified in the historical evolution of Central American social sciences.

The first one is functionalism. Social scientists operating from this perspective do not question the foundations of the social systems within which they operate. Their main objective is the promotion of greater technical capacity in areas such as economics, education and public administration, for the attainment of development objectives.<sup>5</sup>

The second one is an orthodox Marxist approach that is based on a "vulgar" interpretation of Marxism. Vulgar Marxists, according to C. Wright Mills, "seize upon some ideological characteristics of Marx's political philosophy and identify these parts as the whole" (Mills, 1968, p. 96). Nevertheless, orthodox Marxism had a considerable influence on Central American students and intellectuals who opposed the status quo and the notion of development advocated by functionalism throughout the 1970s.<sup>6</sup>

The third approach is Marxist structuralism. Like orthodox Marxists, proponents of this approach are critical of the premises, the methods, and the objectives of "developmentalism" (Arredondo *et al.*, 1984, pp. 20-21). However, they are far more critical in their use and interpretation of Marxist theory than orthodox Marxists, as they are influenced by the work of Gramsci, Althusser and even Weber.<sup>7</sup>

The year 1979 constituted a critical point in the development of Central American social sciences. With the triumph of the Sandinista Revolution, proponents of both the orthodox and the structuralist approaches began to concentrate on analyzing the causes and consequences of the revolution (Aguilera, 1989, p. 22). Orthodox Marxists interpreted this historic event as the inevitable outcome of the "decline of capitalist imperialism", while Marxist structuralists adopted a position of largely unquestioning support for the Nicaraguan revolutionary government. For obvious reasons, this was more evident in Nicaragua, where most social scientists assumed a position of unconditional commitment to the principles of the State.<sup>8</sup>

<sup>4</sup> Kahl's reference is to social analysts in Latin America before World War II. His description does not apply to Central America, however, where social sciences emerged only in the 1970s.

<sup>5</sup> The Central American Institute of Public Administration (ICAP), in the 1970s, and the Central American Institute of Business Administration (INCAE) are examples of institutions that have supported functionalist social science research in the region.

<sup>6</sup> For examples of this type of social science research see Villagra, 1981, and De Castilla, 1985.

<sup>7</sup> Some of the most important exponents of this current of opinion are Edelberto Torres-Rivas, Daniel Camacho, Guillermo Molina Chocano and Gabriel Aguilera.

<sup>8</sup> See, for example, Lanuza *et al.*, 1983.

It is interesting to note that proponents of the functionalist approach in Nicaragua quickly adapted to the changing political climate of the country. Their traditional attitude of supporting the prevailing political system, whatever its ideological orientation, logically resulted in their collaboration with the new Sandinista government.<sup>9</sup>

The collapse of communism in Eastern Europe and the Soviet Union, the electoral defeat of the Sandinistas in the elections of 1990, and the stalemate of the revolutionary process in El Salvador have left the Central American social sciences in a state of intellectual crisis (Torres-Rivas, 1990). Marxist intellectuals have been unable to adapt their theoretical schemes to make sense of the profound political and economic transformation of the world today. On the other hand, functionalist social sciences have become receptive to the notion that history has ended, and that all that is left for Third World social scientists is to contribute to the perfectibility of a new world order.

The crisis of the Central American social sciences, however, is not simply the result of changing international circumstances. Rather, it is the long-term consequence of their imitative character. The end of the Cold War merely exposed the unauthentic nature of many of the concepts, theories and assumptions that have influenced the production of knowledge in the region. It simply showed that the emperor had no clothes.

From their inception, the social sciences perpetuated the notion of Central America as a geographical extrapolation of Europe.<sup>10</sup> This notion was, to a large extent, the result of Central American social scientists' reliance on a textual understanding of European

interpretations of social reality. Textual interpretations of ideas are based on the assumption that "the text provides the 'sole' and 'self-sufficient' object of enquiry. Reading the texts carefully over and over again will prove sufficient for revealing their meaning" (Boucher, 1985, pp. 216-217). From this perspective, the context within which ideas emerged is either bluntly ignored or treated as a matter of historical curiosity. The result of this approach to the study of ideas is a mystification of books and authors, which are perceived as possessing transcendental and suprahistorical qualities.

Social theories, however, are shaped by the spatial and temporal contexts within which the social scientist operates (Gouldner, 1970, pp. 25-60). A knowledge of these contexts adds meaning to the texts produced by scholars, and facilitates an understanding of the limitations of their concepts, theories and ideas.

Transcending "textualism" in the Central American social sciences requires a critical examination of the conceptualization of the time and space relations that have informed the production of local social theory. This examination is essential for the articulation of concepts, theoretical approaches and methodologies that can bring the Central American social sciences closer to the reality they are trying to comprehend and explain.

The political societies studied by the Central American social sciences are the product of a correlation between time and space that is qualitatively different from the time-space relation which affected the formation of political societies in Europe. The legal principle of sovereignty that was formally attached to Central American States by international law lacks the historical, social and political significance that it has for European societies. The Central American States were never capable of containing or expressing their own histories: instead, they have been open receptacles of the history of the West from their inception. Therefore, Central American states have never been spatial expressions of historical time. Rather, they constitute formal and legal arrangements designed on the basis of European interpretations of politics and society. They are the product of the imposition of Europe's political values and traditions on the Indian reality of the region. As a result of this imposition, Europe's past became the historical framework against which the political processes of Central America would be evaluated for the next five hundred years. Self-definitions of European

<sup>9</sup> After the Sandinista victory in 1979, the Central American Institute of Business Administration (INCAE) became an active participant in the training of public employees and in the organization of the Nicaraguan public sector. Jaime Wheelock, one of the most important leaders of the Sandinista movement, referred to INCAE in 1975 as "an institution designed according to the educational model of the United States...its objective is to train the medium-level technicians needed for the administration of the American companies massively established in Central America during the 1960s... In INCAE, a group of American professors are in charge of disseminating the capitalist techniques of exploitation that they have developed, taking as models the exploitative practices of multinational corporations" (Wheelock, 1975).

<sup>10</sup> Ironically enough, the European experience which has influenced the Central American social sciences excludes the Ibero-Latin tradition (For an understanding of this phenomenon at the Latin American level see Wiarda, 1973, 1974 and 1990, and Veliz, 1980).

political actors and explanations of European political practices were transplanted into the region and used, after Independence, to justify the political, economic, and social institutions of the emerging states (see Bradford Burns, 1989). These institutions neither represented nor recognized aboriginal people as a political reality. The Conquest erased the political identities of the continent's first nations by categorizing them as "Indians". This name itself was a negation, for being an Indian simply meant not being European (Ortega Hegg, 1982, pp. 232-233).

The negation of the Indian by the political discourse that explained and justified Central American States and the political institutions engendered by it differs significantly from the exclusion of the working class in Europe in the first part of the nineteenth century. At that time, European liberal-democratic discourse and institutions were designed to sustain a class-divided society. That is, they recognized the political existence of both the rulers and the ruled. Liberal theorists such as Bentham and Mill "accepted and acknowledged... the class-divided society, and set out to fit a democratic structure onto it" (Macpherson, 1977, p. 10). Liberal-democratic institutions and theories, then, excluded but recognized the political force of the workers. As such they promoted the development of political values designed to legitimize their exclusion. In so doing, however, they acknowledged the workers' presence and their potential political role. Thus, the act of exclusion was a purposeful one that acknowledged the political presence and the potential political role of the excluded. Liberal-democratic institutions and practices changed when the political role of the working class began to materialize in the second half of the nineteenth century. Once again, social theory made explicit those changes in order to account for the new political reality of Europe (Macpherson, 1977, pp. 44-76).

Thus, the history of liberal democracy, and of the theory and institutions that sustained it, was also the history of the excluded classes. By recognizing the excluded, liberal-democratic institutions and discourse were able to formulate self-definitions of the excluder, creating a political history that was "national" in scope.

The case of the Central American Indians, in contrast, is one of political exclusion without recognition. The view of the Indian as a barbarian, advocated by people like Gines de Sepúlveda and based

on the Aristotelian notion of natural differences, attempted to justify the Indians' subjugation as a precondition for their christianization and civilization (Zavala, 1971, pp. 64-75). On the other hand, the view of the Indian as "a creature of God, endowed with reason and the capacity for virtue, religion and freedom", defended by Bartolomé de las Casas, argued that religious conversion should be considered as the proper avenue to the political recognition of the Indian as a subject of the Spanish Crown (Zavala, 1971, pp. 53-75). Both views, however, negated the Indian as a political reality and agreed on the necessity of his political transformation and Europeanization, ignoring his history and perceptions of politics and society. Thus:

"the historical being exhibited by America was rejected as lacking in spiritual meaning, according to Christian standards of the time. America was no more than a potentiality, which could be realized only by receiving and fulfilling the values and ideals of European culture. America, in fact, could acquire historical significance only by becoming another Europe" (O'Gorman, 1961, p. 139).

The formation of the political societies of Central America after independence did not change the view of the Indians as non-political entities (Dussell, 1973, pp. 29-32). As Richard N. Adams explains, the regimes that have governed the political societies of Central America since 1821 have been divided "between those who, on the one hand, favour a rigorous liberal policy to achieve labour control through forced, but always strategic, deculturation and social control based directly on threat of force...and those who, on the other hand, favour an *indigenista* policy, also liberal-inspired, but designed to obtain the conformance of Indians to labour controls through 'civilizing' and 'educating' them" (Adams, 1991, p. 181). Therefore, as was also the case during colonial times, the Indian in post-colonial Central America had to "disappear in order to ensure his inclusion in time" (Rodríguez, 1991, p. 56; see also Lovell, 1988).

In addition, the *Criollos* denied their own Spanish past. In its place, the ruling elites of the independent political societies of Central America, like those of the rest of Latin America, "set the shining examples of Britain, France and the United States" (Fuentes, 1985, p. 39). Zea explains:

"At a certain historical juncture the Hispanic American rebelled against his past, and hence against the responsibilities that it implied. He attempted to

make an immediate break with that past. He denied it, by attempting to begin a new history, as if nothing had been accomplished previously. He also created his utopia. He found the ideal to which he aspired in the great Anglo-Saxon countries, England and the United States, or in France, in what it contributed to the advancement of civilization. Their political constitutions, philosophy, literature, and culture in general were models by which the Hispanic Americans sought to mould a new history" (Zea, 1963, p. 12).

The exclusion of the Indians, then, was not based on a political discourse that acknowledged their potential political role. Rather, the discourse of Central American political actors was European and so were the institutions justified by it.<sup>11</sup> The formal political history of Central America was in no way the history of the Indians, who remained outside politics both discursively and institutionally. Like European women prior to the nineteenth century, "they were in, but not of civil society" (Macpherson, 1977, p. 19). They remain, even today, victims and spectators of the formal political evolution of the region.

The non-recognition of the Indian reality and the adoption of a European political discourse by the elites who inherited the colonial structure of Central America also resulted in the falsification of the *Criollos'* political values and institutions (Villegas, 1963, pp. 107-111; Salazar Bondy, 1968, pp. 112-113). Thus, the political discourse of the *Criollos* created a formal political reality—explained and justified by European notions of Liberalism, Conservatism, and later Socialism—that ignored not only the Indian but also the unique and unprecedented role that the *Criollos* played as carriers of a European political history in a non-European political reality. The result of all this has been a "gigantic cover-up of identity" (Zea, 1988-89, p. 35): the formalization of a "legal" country that is European and a "real" country that still remains to be discovered.<sup>12</sup>

As Edelberto Torres-Rivas has pointed out, social scientists in Central America study the "official country" rather than the essence of the "real country" (Torres-Rivas, 1989, p. 2). They have made explicit the European "self-descriptions" of political life in Central America articulated by the *Criollos* and their

inheritors. The result is the legitimization both of Central America's political history as an imperfect version of European history, and of a Eurocentric tradition of social sciences in which explanations make sense only because we assume that the Europeanized version of the evolution of Central America is the true history of the region. In this context, the social sciences have become part of the problem rather than part of the solution of the entanglement of Central America's history.

By concentrating on the formal political discourse and on the evolution and functioning of the *Criollos'* political institutions and practices, Central American social scientists implicitly assume that the European and Central American realities can be studied with the same metatheory—that the nature of the social reality of Central America is similar to that of Europe. The consequences of this assumption have been tragic. The uncritical use of European social theory for the study of Central American societies has produced an illusory knowledge of the region's social, economic and political evolution and problems. This result is to be expected, since social theory is shaped by the very social reality that it tries to make explicit. From this perspective, social theory's capacity to grasp social reality is conditioned by the pre-theoretical conceptions of social life held by the scientist before he or she tries to explain the nature of social phenomena. The tensions derived from the intimate relationship between social reality and the aims of social theory are explained by Alvin Gouldner:

"... while aiming to account for a set of events that extend beyond the sociologist's facts or personal realities, social theories are at the same time influenced by his prior imputations about what is real in the world, whether these are his facts or personal realities" (Gouldner, 1970, p. 44).

The European social sciences, then, have been shaped by Europe's history. As such, their theoretical tools have been designed to give priority to those features of the European historical evolution that are regarded as essential by social scientists. In this sense, they have a built-in predisposition to recognize specific social actors, processes and institutions.

The uncritical application of European social sciences to a non-European reality could produce three different effects. First, it might recognize those aspects of social reality that are identical in both the European and the non-European political experience; second, it might entirely miss segments of the non-European reality; and finally, it might mistakenly

<sup>11</sup> By "European" we refer to the countries of Central and North-west Europe (Wiarda, 1990, p. 396).

<sup>12</sup> The distinction between the "real" and the "legal" country is taken from Fuentes, 1985, p. 11).

impose a European identity on segments of non-European reality that appear European.<sup>13</sup> Since we have argued that the relation between time and space which conditioned the emergence of the State in Europe is different from the time-space relations which conditioned the formation of the Central American State, the first possibility can logically be eliminated. The different time-space relations in Europe and Central America produced different types of State and different types of political actors and institutions. Thus we are left with the two latter possibilities regarding the application of European social sciences in Central America.

The incapacity of European social sciences to capture salient features of Central American reality is evident in the research agenda of the region. In countries like Guatemala (where they form more than half of the population), Indians have been practically ignored by social sciences because their situation is not regarded as a typical sociological or political issue. Consequently, the study of the Indian issue has been left to anthropology, which implicitly reduces its importance (Torres-Rivas, 1989, pp. 2-4; Smith, 1990, p. vii).<sup>14</sup>

The uncritical application of European social sciences to Central America can also result in the misrepresentation as European of segments of the local social reality that have a formal European appearance, as occurs in the case of the State, the formal patterns of political conflict, and the political actors in the region.

Central American social sciences mistakenly assume that the principle of national sovereignty is the natural point of departure for the study of Central American political societies, and that the patterns of political conflict in the region are determined by social actors and forces predominantly operating within the State in a manner that only marginally

differs from the European experience.<sup>15</sup> Liberal and Conservative scholars based their analysis of the political history of these countries on voluntaristic interpretations of history in which the personal qualities of leaders are regarded as the forces that have determined the evolution of the region.<sup>16</sup> This evolution is usually depicted as an historically predetermined and progressive evolution from the condition of underdevelopment to the condition of development. Marxist scholars, on the other hand, look at the evolution and transformation of the economic structure of individual societies and analyze the class tensions that result from that process.<sup>17</sup> Thus, the study of the State in Central America implicitly assumes that Central American history is a re-run of European history and that the region replicates the social laboratory and the historical mix of circumstances and values that produced Conservative, Liberal and Socialist institutions and ideas in Europe. These studies identify political periods, historical patterns and actors that are surprisingly similar to those studied by social scientists in Europe. Thus, Central American social scientists have come across the existence of national bourgeoisies, proletariats, and even "peasant bourgeoisies" in the countries of the region, while ignoring the "Indian issue".<sup>18</sup> In European history and in Western social sciences, the concepts of the "proletariat" and the "bourgeoisie" contain the accumulation of a long historical experience. In the absence of this experience, these concepts have little or no theoretical value. Ownership of the means of production as a criterion to differentiate social classes is only the legal expression of a complex historical phenomenon that is "not merely economic in the strict sense but also ecological, social, political, and socio-psychological" (Wolfe, 1982, p. 21). In Central America, on the other hand, the concept of class is a name rather than a container of historical experience.<sup>19</sup> In consequence, the image of a European re-

<sup>13</sup> Marx was a victim of his Eurocentrism when he interpreted the emergence of Simón Bolívar as the Latin American version of French Bonapartism (Sánchez Vásquez, 1988-89, p. 115).

<sup>14</sup> It is important to remember that anthropology emerged in nineteenth-century Europe as a discipline dedicated to studying marginal people in marginal areas of the world; as such, it differs from sociology, which concentrates on the study of European societies (Wallerstein, 1984, p. 312; Ehlers, 1990, pp. 141-142).

<sup>15</sup> See, for example, Vega, 1981; Torres-Rivas and Pinto, 1983; Lanuza, Barahona and Chamorro, 1983; Posas and Del Cid, 1981; Torres-Rivas, 1980; Asociación Centroamericana de Sociología (ACAS), 1989; Molina Chocano, 1982.

<sup>16</sup> See, for example, Reina Valenzuela and Argueta, 1978.

<sup>17</sup> See, for example, Wheelock, 1975.

<sup>18</sup> The concept of "peasant bourgeoisie" is used by Arias, 1985.

<sup>19</sup> For an analysis of concept misinformation, see Sartori, 1977.

ality has been transformed into the Central American reality, and the production of knowledge in social sciences has been transformed into the formulation of intellectual images of an imaginary reality (Salazar Bondy, 1968, p. 114). Needless to say, the consequences of these misinterpretations are both theoretical and political. For example, the post-1979 mistreatment of the Miskitos on the Atlantic coast of Nicaragua by the Sandinistas was rooted in an imitative and Eurocentric Marxist theoretical tradition that did not recognize the Miskitos' historical reality and was incapable of comprehending their unique social and political views. In their attempt to institutionalize a Socialist revolution, the Sandinistas treated ethnic minorities on the Atlantic coast of Nicaragua as marginal variations of an imaginary national proletariat. This view, as Carlos Vilas has pointed out, was:

"reductionist and incomplete. The different social organizations of the Costeño groups, the articulation of production relations to the kinship system, the different modalities of legitimation and exercise of authority, ideological and linguistic differentiation, and different historical processes were reduced to a geographically distinct manifestation of the problem of economic backwardness. The revolutionaries' lack of knowledge about the ethnic question led them to

privilege the Costeños' most obvious material traits: they were poor farmers and mine and lumber company workers, exploited by foreign capital and merchants. At the same time, certain cooperative productive practices based on reciprocity (such as *panapana*) and certain characteristics of village life were interpreted as survivals of primitive communism" (Vilas, 1987, p. 96).

In general, the strategy of class struggle followed by the radical Left during the revolutionary 1960s and 1970s was based on Eurocentric interpretations of the concept of social classes. The theoretical lenses used to produce these interpretations could not recognize the Indian reality of the region unless Indians were dressed in European clothes—that is, unless they had been "depeasantized" or "proletarianized" (Allahar, 1989, p. 119).

Thus, Central American social sciences have legitimized the use of Europe's history as the proper foundation for the analysis and evaluation of Central America's reality. They have perpetuated in the region a state of mind that Antonio Gómez Robledo characterizes as "philosophical submission". This state of mind is, according to Gómez Robledo and Augusto Salazar Bondy, "the correlative, at the spiritual level, of political submission" (Gómez Robledo, 1946, p. 189; Salazar Bondy, 1968, p. 40).

## IV

### Social theory and social practice: closing the gap

With the end of the Cold War and the decline of revolutionary movements and ideologies in Latin America, Central American social scientists have begun to explore the possibilities and limitations with regard to national consensus on the organization of political life, particularly in Guatemala, El Salvador and Nicaragua (Solórzano, 1986; Torres-Rivas, 1987; Pérez, 1991). Most observers agree that, at the very least, this consensus "must include agreements regarding the permanent rules governing competition for public office; the resolution of conflicts; the reproduction of capital; and the appropriate role of the State, with particular reference to the military and the bureaucracy" (Karl, 1986, p. 10). The possibilities for Central American social sciences to make a

positive and effective contribution to the articulation of national political consensus will depend to a large extent on their capacity to transcend Eurocentrism and close the gap between social theory and social practice (see Dahrendorf, 1983, p. 36).

Social theory provides "the constitutive understanding necessary for continuing, reformed, or purified practice" (Taylor, 1983a, p. 16). Therefore, mental experience is not independent from social reality. Different perceptions of life, different definitions of what is right or wrong, legitimate or illegitimate, can create different understandings of the nature of social institutions. In turn, these understandings shape social practice and, through it, the very institutions that they try to elucidate (Taylor,

1983a, p. 12). Thus, the role of social theory is not only to explain social life but also to "define the understandings that underpin different forms of social practice..." (Taylor, 1983a, p. 20). By making explicit the meaning of social action, social theory becomes an active participant in the making of the very history it tries to explain. Social scientists, from this perspective, "are in the business of proposing and fashioning ways of looking at, thinking, and talking about—and hence contributing to the construction and deconstruction of social objects" (Gouldner, 1973, p. 105). Therefore, the goal of achieving in social sciences the type of objectivity achieved by the natural sciences is misleading and inappropriate. The test of good social sciences is not objectivity but authenticity. The concept of authenticity has been used by Leopoldo Zea and Augusto Salazar Bondy to criticize Latin American philosophers' tendency "to borrow indiscriminately from the West and to manufacture faulty copies of European doctrine..." (Lipp, 1980, pp. 115-116). This tendency "has been conducive to producing an unauthentic philosophy based on an unauthentic existence" (Lipp, 1980, p. 116). Authenticity, then, "refers to a characteristic that flows naturally out of a given set of circumstances, or a product which is inherently part of an organic whole and not derived from an alien body of thought" (Lipp 1980, p. 116). From this perspective, the compromise of social sciences is not with an ideal view of the world but with ideas that are rooted in, and shaped by, the historical conditions within which social scientists operate. Penetrating and explicating social practice is thus the first and foremost function of social sciences. Charles Taylor explains:

"If theory is about practice here, then what makes a theory right is that it brings the practice out in the clear. And what this leads to is that the practice can be more effective in a certain way. Not just in any way, but in the way practices can be when we overcome to some degree the muddle, confusion, cross-purposes which affect them as long as they are ill-understood. To have a good theory in this domain is to understand better what we are doing; and this means that our action can be somewhat freer of the stumbling, self-defeating character which previously afflicted it; our action becomes less haphazard and contradictory, less prone to produce what we did not want at all" (Taylor, 1983b, p. 78).

Fostering the capacity of Central American social sciences to elucidate social practice involves developing their ability to elucidate the "real country" of meanings and perceptions underlying social action

in the region. Only an understanding of the interpretations of social reality guiding the practice of social agents in Central America can create conditions appropriate for the articulation of national consensuses that can bring peace and prosperity to the people of the subregion. Making sense of agents, as Charles Taylor points out:

"does require that we understand their self-descriptions. We may—indeed, often must—take account of their confusion, misinformation, illusions, but we make sense of them if we grasp both how they see things and what is wrong, lacunary, contradictory in this" (Taylor, 1983a, p. 30).

Understanding agents' self-descriptions and interpretations of social reality in Central America requires identification and explanation of the network of intersubjective and common meanings that constitute the foundations of social practice in the region. Charles Taylor defines the concept of "intersubjective meanings" as "ways of experiencing action in society which are expressed in the language and descriptions constitutive of institutions and practices" (Taylor, 1985a, p. 38). They represent society's common comprehension of social experiences as it is expressed in language and social practice.

The existence of a network of intersubjective meanings should not be confused with the existence of political consensus (Taylor, 1985a, pp. 36-37). Intersubjective meanings can be the foundation of both consensus and disagreement. They simply provide a common language through which members of society can agree or disagree on the nature and organization of social and political life. Through their agreements and disagreements, members of society participate in the constitution of social and political reality.

Intersubjective meanings are essential for the emergence and development of "common meanings". These are "notions of what is significant, which are not just shared in the sense that everyone has them, but are also common in the sense of being in the common reference world" (Taylor, 1985a, p. 38) In other words, common meanings represent points of convergence concerning the identification of relevant aspects of social and political reality. Taylor explains:

"Common meanings are the basis of community. Intersubjective meanings give a people a common language to talk about social reality and a common understanding of certain norms, but only with common meanings does this common reference world contain significant common actions, celebrations, and feelings. These are objects in the world that

everybody shares. This is what makes community" (Taylor, 1985a, p. 38).

The existence of common meanings still does not guarantee political consensus. They represent areas of social and political concern that are considered important by members of society. They might even represent common goals and aspirations. However, political conflict can emerge as a result of different understandings of the proper ways to achieve them. Political consensus is rooted in both intersubjective and common meanings. The existence of both of these—a common language that members of society can use to express their agreements and disagreements, and some points of convergence regarding social and political issues and priorities—is a necessary but not sufficient condition for the articulation of political consensus.

The most important contribution that social sciences can make to the search for peace and stability in Central America is to explicate the intersubjective and common meanings that guide social action in the region. This task calls for the elucidation of both the Indian and the *Criollo* self-definitions and explanations of social reality.<sup>20</sup> The *Criollos'* self-definitions and explanations of their social condition, inherited and reproduced by the ruling elite of the region, have to be approached as mirror images of a European reality (Stone, 1990). Like the

images in a mirror, they are both real and unsubstantial; they hide as much as they reveal. If they fail to transcend these images, the Central American social sciences are condemned to remain ignorant of the fact that it is the combination of visible images and hidden realities that give content and meaning to Central America's formal political processes and institutions (Salazar Bondy, 1968, pp. 112-133).

The Central American social sciences also have to penetrate the Indian reality of the region to uncover the intersubjective and common meanings that constitute the existential foundation of Indian communities. Knowledge of the Indians' interpretation of social, political and economic reality is essential to identify mental bridges that can link the Indian and the *Criollo* worlds of Central America (Matul Morales, 1989).

It is important to note that the Indian and *Criollo* dimensions of Central American reality are not necessarily located within easily recognizable population groups. With the exception of Guatemala, the population of the Central American countries is predominantly mestizo. The mestizo is the embodiment of both Spain and Indian America, and incarnates both the "real" and the "legal" country. His duality is the duality of our political existence: the past that we have rejected and the future that we cannot achieve.

## V

### Conclusions

The recommendation to revise the time-space relations that created the conditions for the emergence and development of Central American States means implicitly that the region's social sciences must articulate their own metatheory. This requires an explanation of the intersubjective and common meanings that underline our social practice. In studying the hidden dimension of Central

American politics, the social sciences should pay special attention to the cultural foundations of Central American political life. Fiction, folklore, narrative and religion contain important clues to the political identity of the region and its actors. They offer the possibility of articulating a metatheoretical foundation that can sustain the theoretical work of authentic social sciences.

The preceding argument should not be interpreted as a call to ignore the intellectual contributions of European social sciences or the real influence of Europe on Central America's historical evolution: this would be juvenile, counterproductive and irresponsible. European social sciences must be used to articulate "a language of perspicuous contrast" (Taylor, 1985b, p. 125). This is a language that can

<sup>20</sup> In this article we have made reference to the *Criollo* and the Indian dimensions of Central American reality. However, the development of authentic social sciences also requires the identification and explanation of the network of intersubjective and common meanings underlying the social practice of the region's black population and other minorities (Rout Jr., 1976, pp. 261-279).

be used to elucidate both the European and the Central American realities "as alternative possibilities in relation to some human constants at work in both" (Taylor, 1985b, p. 125).

Furthermore, Central America, like the rest of Latin America, "is a vast, original, modulation and modification of Western culture" (Merquior, 1991, p. 158). Therefore, the imitative nature of Central America's political development is part of the region's reality. This imitation never has been and never will be fully successful, for Central America already had a history before Europe imposed its values and institutions on the New World. This forgotten history continues to leave its mark, upsetting the implementation of European utopias, distorting political ideas and

practices. In short, it creates and maintains a gap between the "real" and the "legal" country. The most important task of the Central American social sciences is to close this gap in order to light the way towards more effective social practice. The fulfilment of this task involves neither the nostalgic reconstruction of a forgotten past nor the visionary articulation of a utopian future, but the construction of a new language, a new culture, and a new community that is rooted in the multidimensional makeup of our historical existence (Gouldner, 1973, pp. 104-106). Only then will the Central American social sciences be able to contribute to the articulation of durable national political consensus and stability.

(Original: English)

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# The history of the *social stratification* of Latin America

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Sociology's contribution to our understanding of the Latin American development process has been closely linked to studies on the social structure and stratification of the region and to analyses and interpretations of the various social groups' characters and behaviour. This investigative effort has been directed towards ascertaining the specific forms taken by the structure of social groups and classes in the region, since it had been postulated that these traits –which are an inherent part of Latin America– were determinants of the patterns which the development process would follow. The present article reviews the main interpretive approaches which have been or are still being used today by Latin American sociologists for the study of the main social groups' and classes' attitudes and forms of behaviour. The profound nature of the changes now taking place provides grounds for a reconsideration of the hypotheses made in this connection; the aim of this re-examination should be to retain the valuable aspects of these hypotheses and to use them as a basis for their further development and perhaps for the formulation of new hypotheses as well.

# I

## Social structure and stratification

As Latin America moved into the second half of this century, its development options were not only becoming a subject of concern in governmental and political circles but were also one of the main focuses of sociological thought. Sociology's contribution in this field was to point out just how important an understanding of the social structure of the Latin American countries had become, in view of this structure's dual role as an essential condition for the dynamics of change being experienced at the time and as a determinant of the features specific to the societies of these countries. The research usually cited in this connection includes the pioneering work of T. R. Crevenna (1950-1951) and a series of country studies that were conducted soon thereafter. The focus of this article, however, will not be the substantive content of these studies; instead, we will seek to offer a necessarily brief retrospective view of the interpretive approaches taken to the subject of the social structure and stratification of the region because today, given the thorough-going changes that have occurred, there appears to be an urgent need to redefine these approaches and to propose new perspectives that will explain the current dynamics of change.

Only a few of the authors who have dealt with the subject and who are felt to be representative of broader schools of thought will be selected for discussion, although we are aware that any selection process entails the risk of omitting important elements. That risk notwithstanding, there does seem to be general agreement as to the fact that Gino Germani (1955 and 1968) has had a profound influence on our understanding of social structure and stratification in Latin America; although his studies refer specifically to Argentina, the interpretive framework which he formulated has been widely used in the region. Germani was mainly concerned with understanding the special features, in countries such as those of the region, of the modernization process that

was clearly taking place within them. The countries' patterns of social stratification reflected the modalities of that process, which, although it did indeed have certain universal characteristics, also displayed some traits that were clearly specific to the region. For purposes of illustration, Germani drew a distinction between two different types of societies. The first was a traditional society in which the social strata corresponded to clearly differentiated estates, there tended to be little or no social mobility, and the principle of adscription applied to individuals; basically, social status was determined by a person's station at birth. In contrast, the second type of society, a modern society, exhibited a number of different strata (this could also happen in a traditional society, such as a caste system), but the most important point was that the dividing line between one stratum and the next tended to become blurred, and the whole of society took on the nature of a continuum. Germani also assumed a high degree of social mobility, to which migration contributed. In this type of society, the criterion of adscription used in determining social status and in assigning social roles was replaced by that of individual performance or achievement, due to the importance which this form of achievement was taking on. Both of these types of societies were, of course, schematizations that to some extent served heuristic purposes similar to those performed by idealized models, which bear varying degrees of similarity to reality.

Germani also used another type of schematization as a model for comparison with Latin America. In so doing, he referred to the social stratification process in the countries where capitalism had been born. In this scheme, he postulated the existence of three phases or stages of capitalist development which corresponded—here, too, in a simplified form—to three types of societies. The first phase would be characterized by a still large primary sector, a rudimentary secondary sector and a relatively small tertiary sector. The social groups found at this stage of development would be a still powerful but declining upper class; the bourgeoisie, which would be in the process of becoming a majority; and an urban

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■ This article is based on the study "Estructura social y estilo de desarrollo en América Latina", prepared in conjunction with Rodrigo Baño for the ECLAC Social Development Division.

proletariat, which would be beginning to form political groups. In parallel with this, the relative position of rural sectors and of the petty bourgeoisie would grow weaker.

The second phase, which was seen as a transitional stage, would be marked by the decline of the primary sector and the expansion of the secondary sector; the tertiary section would have grown as modern services were developed. As the secondary sector grew and the tertiary sector changed and expanded, those who performed supervisory or leadership roles and the members of the bureaucracy would gain in importance in the new type of society that had taken shape. The middle class as a whole would have grown, but would also be displaying some instability in its make-up as new groups emerged and the fortunes of others waned. The urban proletariat, which would also have grown thanks to the expansion of the secondary sector, would become more organized, but it would also become increasingly differentiated, and what was to be known as the working-class aristocracy would become clearly discernible as a group. Generally speaking, an increase in social mobility would also be observed.

The third phase of capitalism—in the countries where it originated—would be characterized by a small primary sector, a stable secondary sector and an intensive expansion of the tertiary sector. A hallmark of this stage would be the separation of ownership from the control of business enterprises and economic activities, which would entail the emergence of a large technocratic sector. The middle class, for its part, would become more stable, in clear contrast to the preceding transitional stage. Among wage-earners, a distinction would begin to be made between manual and non-manual workers. The whole of society would be “moving forward”, and this advance would be perceived by the various social groups as well as by the people as individuals. The result would be a society-wide satisfaction with the situation, except among certain “marginal” groups.

The two schematizations outlined above, which, as noted earlier, Germani used for heuristic purposes as models for comparison with Latin America, entail an implicit theory of modernization, and his postulates regarding social structure and stratification formed part of that theory. Moreover, and especially in the second scheme relating to the phases of capitalist development, the important elements of the analysis of social stratification are the structural transformation of the economy and the concomitant

changes in the social structure, which involve both the emergence, decline or disappearance of what might be called “functional groups” and the power relations established among the various groups and classes.

Germani developed a series of schemes for Argentina and for Latin America that depict the particular historical aspects of their processes of change and transformation. He argued that, unlike what occurred in the development of capitalism's originators, in Latin America the modernization process took place under the direction of “modernizing oligarchies”, whose economic power base was founded upon a commodity-exporting economy rather than primarily upon an industrialization process; the traditional groups which saw their power decline were the ones that had no ties to the export sector. Another important aspect of the modernization process was the significance taken on by the middle class, and above all by those segments with links to bureaucratic organizations (especially those in the public sector, but in the private sector as well). These groups led the multi-class political and social movements that stood up to the oligarchy. The organized proletariat, with some exceptions, was relatively weak and therefore joined ranks with these movements without maintaining a clearly-defined sphere of autonomy or identity. The import-substituting industrialization process that took place in many countries of the region led to a fuller incorporation and integration of the middle class. At the most advanced stages of the process, the upper class—composed of the long-established landholding and industrial bourgeoisie—was joined by a new bourgeoisie which was also linked to manufacturing; the middle class was more heavily dependent upon the existing social structure, and the proletariat grew, but marginal groups also began to expand and, what is more, they did so at a rapid pace.

Bearing all this in mind, Germani, in seeking to deal specifically with the problem of how to go about studying and analysing social stratification in actual cases, saw a need to arrive at an understanding of the occupational distribution of the population, the rank or status attributed to the different occupations according to the predominant sociocultural criteria, and the lifestyle associated with those occupations, including both economic standing and other traits, particularly educational levels. He also placed importance on the social class with which people in the various occupations identified and on the differing belief systems, standards and values of occupational groups which distinguished them from one another.

The occupational structure thus acted as the very foundation for social stratification in Latin America, whose components were as follows: (i) *Rural upper and middle classes*: Primary-sector managers, entrepreneurs and employers, and "family help" and employees in the same sector; (ii) *Urban upper and middle classes*: Managers, entrepreneurs and employers in industry, commerce and services; "family help" working in firms run by the head of household; self-employed workers in the graphics/printing/paper industry; those whose line of business was wholesale commerce, exchange operations, office work, public entertainment, hotels and catering, health services or overland transport; employees and trainees in the secondary and tertiary sectors; and rentiers, retirees and pensioners not included in the economically active population but whose characteristics correspond to the middle class; (iii) *Rural working classes*: Manual workers, apprentices and self-employed workers in the primary sector; and (iv) *Urban working classes*: Manual workers and apprentices in the secondary sector, commerce and services, and self-employed workers in all branches of industry, commerce and services.

José Medina Echavarría addressed the subject of Latin America's social structure and stratification on a number of occasions (1964, 1967 and 1973). He was concerned with exploring the historical peculiarities of the Latin American social structure, which he considered to be of key importance in understanding the modalities of its development and in determining how it might meet the challenges of modernization, whose more general, universal aspects appeared to be virtually inescapable. He was thus aware of how stratification systems changed over time and of the fact that relatively simple schemes reflected only a given period in the Latin American countries' history, such as the years during which the *hacienda* system predominated. He was also aware, however, that even during that period new groups were forming in the cities—of merchants, members of the liberal professions and others—who were displaying a limited but growing degree of autonomy from the traditional oligarchy. A variety of factors that had played a role in the historical process of change were steadily increasing the complexity of the system of social classes and groups. The emergence of new strata, which then moved on to play significant roles in society, ultimately brought on the crisis of the traditional system, which left a series of

problems and challenges in its wake. The changes taking place in the region's stratification were, in his view, almost directly connected to changes in its economic structure. He perceived the trend towards the predominance of manufacturing and services at the expense of the primary (mainly agricultural) sector, which had led to the formation of new upper classes (or, more precisely, bourgeoisie) and of new middle-income strata and working (especially manual workers) classes. The phenomenon he underscored was the burgeoning growth of the cities and the progressive shrinkage of rural groups, many of whose members joined the ranks of the urban classes.

Medina Echavarría made reference to the formation of an industrial society, which certainly was not repeated *pari passu* in Latin America but which exhibited a pattern that, within certain bounds, was generally valid. He contended that the upper class underwent a transformation as it changed over from a traditional aristocracy to a modern bourgeoisie; that a new, steadily growing sector—the middle class—emerged which then occupied a position of singular importance in the industrial structure; and that the lower classes also experienced a transformation as an urban working class emerged which took the place of the more traditional craftsmen and eclipsed the peasantry.

In this author's eyes, the change in structure itself implied a high degree of social mobility associated with the growth of the middle classes and the rural-urban population shift, which, in his view, entailed a considerable step up in the social scale. This type of mobility could be more accurately described by the term "structural mobility". He also believed that the new industrial society was a society of open classes, and therefore exhibited not only structural mobility but also another sort of mobility that was inherent to that type of society. His vision of industrial society involved concepts such as those found in Germani's work: the principle of adscription tended to be replaced by that of personal merit, and the estate-based society, or caste system, gave way to a class-based society. He emphasized that in industrial society, equality of opportunity—at least in theory—was essential in order to achieve an optimum distribution of the population among the various specialized activities being pursued. One might even say that this form of equality was characterized as a functional requirement of the new society. He felt that the predominance of a certain type of rationality

—an instrumental rationality— was an intrinsic part of industrial society. The division of labour—in that society— was now determined by that rationality's emphasis on freedom of choice. To be sure, he did realize that there might be some sort of hiatus between the heralded equality of opportunity and the actual possibility of promotion or upward movement, but there would always have to be some possibility of free circulation by individuals so that they might be incorporated into the system of occupational specialization.

It is important to note that, for Medina Echavarría, the above-mentioned traits of industrial society took on the character of an idealized model which he then contrasted with another idealized model, that of traditional society. These contrasts between the two do, certainly, contribute to our understanding of the particular nature of Latin American societies. He used this technique to highlight a number of pivotal features, such as the degree of institutional specialization. Whereas, in traditional society, most functions are concentrated in a few institutions, industrial society generally has specialized institutions, each with its own limited, specific task to perform. Furthermore, in traditional society the predominant form of action in any given situation is specified, is prescribed in a fairly rigid fashion. In industrial society, on the other hand, forms of action are deliberated upon; society offers a number of guidelines to be taken into account when making a choice, but the essential element is the choice itself (deliberation), which is imposed by the social structure.

Medina Echavarría was especially interested in social behaviour as it related to development and change, and in this regard he saw a particularly clear contrast between traditional and industrial society: "Traditional and industrial society are diametrically opposed to one another in their attitude to change. Traditional society exalts the legacy of the past. Industrial society, in contrast, values and stimulates all change; in other words, change is institutionalized" (Medina Echavarría, 1967, p. 49). He also discerned another especially important facet of industrial society having to do with its political organization and foundations. He felt that, in the past, industrial society had been linked to a particular political model, that of liberal democracy. He was aware that this view was not entirely accepted by many scholars and might therefore need to be reviewed in the future. None the less, he believed that, regardless of the type

of political structure which industrial society might adopt, this type of society appeared to demand a greater degree of political participation on the part of increasingly broad sectors of the population. Although the above statements may indeed be controversial, they do underscore at least two subjects of interest: the presence of a relatively favourable attitude to change, and the topic of political participation and its forms. At one point in our history, these two questions were of pivotal importance, and sociology strove to provide some sort of answer.

Using this typology, Medina Echavarría highlighted the permeability or flexibility of the traditional system of domination as a specifically Latin American trait. Although it is true that the traditional dominant groups or, in the broad sense of the word, oligarchies had resisted the changes which would tend to displace them, it is also true that they accommodated to those changes to some extent in order to survive. Because of the way in which they did so, however, the modernization process was distorted. Moreover, owing to the mechanism used for this distortion-producing adaptation, the crisis of the traditional system did not end in a total breakdown of that system. Although a more complex form of social stratification did take shape, traditional forms of domination did not completely disappear; instead, by transforming itself, part of it managed to remain in operation. It refused to disappear, and to some extent its resistance was successful.

The idea of structural dualism is closely linked to the above. This dualism is, to be sure, characteristic of a transitional phase—in this case, from a traditional society to a modern society. It is also manifested in the coexistence, at any given point in time, of countries at different levels of development. An even more significant type of dualism, however, is the coexistence within a single country of some zones which more closely resemble the model of an industrial civilization and others that are closer to the traditional model; of modern cities and traditional cities, of rural zones that are the prototype of traditional society and others that are taking on the characteristics of an industrial society. In Latin America, because of the distortion-generating flexibility mentioned earlier, the relationships between modern and traditional elements have become extraordinarily complex and intricate.

This coexistence of tradition and modernity gives rise to asynchronies which are then manifested in various spheres of society. There is, for example,

some asynchrony in the process of change as it applies to the attitudes and modes of behaviour of the various strata, which to some extent explains the reason for the role played by society's elites. The change "usually begins in certain sectors of the urban elite and then spreads downward to the various strata of the population, from the highest to the lowest" (Medina Echavarría, 1967, p. 54). But this asynchrony is not limited to the behaviour of people; it is also to be observed in institutions. Thus, Medina Echavarría also concluded that "if institutions do not change at the same pace –and, at times, in the same direction– in a given location and point in time, then some institutions will be closer to the traditional model and others to the industrial model"; [therefore] "it is possible that the technical/economic structure may have moved in the direction required by the industrial model while other spheres have lagged behind. Or vice versa. In any event, these asynchronies may be found in different parts of the social structure" (Medina Echavarría, 1967, p. 53).

The above-mentioned author's main concern regarding this subject was the possible implications in terms of the Latin American countries' development options. The underlying assumption was that the technical/economic structures of the industrial model would require motivations geared to those structures and would therefore be unable to function on the basis of the motivations associated with traditional society. As noted earlier, asynchronies could be observed in the behaviour of both individuals and institutions, and in the relationships between the two as well. Thus, even if certain types of changes took place in the occupational structure, the necessary changes in terms of the motivations, attitudes and feelings of the persons concerned might not come about. Another possibility was that people's attitudes had indeed changed in the way called for by industrial society but that the technical/economic, educational, political and other apparatuses of society had stagnated. In concrete terms, Medina Echavarría warned, it was possible that people's aspirations and attitudes in regard to consumption, their lifestyle, etc. would come to resemble those associated with industrial society but that production would remain at a limited or insufficient level of development. Thus, Medina Echavarría's contribution in this field lies in having addressed the subject of the transformation of the social structure and stratification, and those features of that transformation specific to Latin America, and in having underscored the need to link structural changes affecting social groups and strata

with the values and attitudes that guide the behaviour of the groups in question.

To those authors whose views were more closely associated with Marxist thought, the question of social stratification –or, more precisely, the issue of social classes– appeared to be closely linked to the specific features of capitalist development in the region, and this, as they noted, differed substantially from what might be regarded as the original model. One such author, for example, is Florestán Fernandes (1968 and 1973), who spoke about the difficulty of referring to a class society in Latin America, where capitalism was not, in large measure, the result of an internal evolutionary process and, by its very nature, lacked the capability to create conditions conducive to autonomous development and self-sustained growth. Consequently, the social classes (with the term being defined here as those that form under a capitalist system) did not take in the whole of the population, a large part of which was divided into "social categories" rather than classes. The "class system" was thus limited. Although there were enormous differences between one and the other, they were superimposed upon other social categories (the marginalized, the dispossessed, the extremely poor) and enjoyed a position of some privilege, inasmuch as it was often only they who were able to participate in fundamental decision-making. Furthermore, the classes that did exist did not perceive themselves as such and tended to deny that identity to the other social categories as well.

According to Fernandes, Latin America encompassed a mix of differing stages of economic evolution, at least at the time when he was writing, and it was therefore impossible to talk about a universalization of capitalist market forms. One particularly significant fact was that in large sectors of the economy –in the agrarian sector, for example, but in others as well– it was possible to appropriate labour on a basis that was not, strictly speaking, capitalistic, i.e., in terms of a labour market. It followed from this proposition that the fundamental difference was the possession of goods or the lack thereof. The *category of possessors* included the capitalist sectors as such and other forces having certain class traits, such as the rural upper sectors. In fact, Fernandes drew a distinction between a rural upper class and an urban upper class composed of industrialists, burghers, large-scale traders or merchants, high-ranking or highly-skilled professionals, etc. He also defined an urban middle class which, although it was not, strictly speaking, a

“possessor”, associated its interests with those of the possessors; this included a traditional middle class and a modern middle class. The category of *non-possessors*, which was formed by a wide array of different groups, included those belonging to subsistence economies or archaic economic structures and those who were actually beginning to take on the identity of wage-earning proletarians.

Although they did run into difficulties in this area, Marxist-inspired authors strove to apply theoretical concepts taken from that body of thought to their analysis of the Latin American social structure and stratification. Many of them focused on certain groups, such as entrepreneurs or workers; but others, such as De Ipola and Torrado (1976), also tried to apply more comprehensive schemes. These two authors developed a theoretical scheme based on the concept of the social division of labour in capitalist society. On that basis they postulated the existence of what appeared to be a determinative production relation. This production relation was—in Marxist terminology—an exploitative relationship that gave rise to two major groups: actual workers and those who appropriated surplus labour. Thus, one group was made up of “exploited” persons and the other was formed by the “exploiters”, and the two were seen as constituting the social classes. In addition, these authors also identified other relationships which were defined by that determinative production relationship and which, on that basis, arose between the agents of production and the means of production involved in a historically determined social production process. These relationships were basically the following: (i) *relationships of ownership*, which might take the form of individual private ownership, collective private ownership, and even private social ownership, with the latter term referring to cases in which the bearer took the form of the entire class of owners as a unit; (ii) *relationships of possession*, which were the relationships existing between some agents of production and the means of production involved in the production process. Through such relationships this type of agent acquired the power to direct and coordinate the production process, thereby ensuring its operation; (iii) *technical control*, which was the relationship between some agents of production and the means of production involved in the labour process. Through this relationship, these agents acquired the ability to set the relevant means of production into motion; and (iv) *deforcement*, which referred to the relationship between direct producers and means of production when those means were

directly involved in the labour process. Each of these relationships implied its opposite, i.e., non-ownership, non-possession, an absence of technical control and non-deforcement.

The social division of labour would determine the distribution of agents of production as a function both of determinative production (exploitative) relationships and the production relationships defined by determinative relationships (ownership, possession, technical control and deforcement). The former were reflected in the social classes while the latter were reflected in social strata, which were composed of sub-sets of agents within a given social class who held different ranks.

This social division of labour was specified through the “division of social labour”, which determined the distribution of agents of production among the various sub-processes and sectors of activity; this made it possible to identify class segments such as, for example, the industrial bourgeoisie, the commercial bourgeoisie, the financial bourgeoisie, etc. There was also a technical division of labour, which related to the allocation of tasks and functions within each labour process without reference to social production relationships. Finally, “production units” could be defined which were actually economic units (such as business firms, banks, shopping centres, etc.) involving different ranks of functions and levels of decision-making (e.g., concerning supervision, monitoring or execution).

Alongside the economic processes of a given mode of production, non-economic processes were also taking place, with the main ones being legal/political and ideological processes that ensured the conditions necessary for the reproduction of the production process. These processes had their own apparatuses; for example, in the case of legal/political processes, the apparatus included the armed forces, the courts and political parties. In the case of ideological processes, it included the family, the schools, religious institutions and the mass media. The people involved in these non-economic processes formed social categories.

According to the above, the scheme of the social structure in a classist mode of production would be determined by a social production process that generated antagonistic relations based on exploitation, i.e., class struggle. The social production process could thus be broken down into a direct production process which gave rise to class segments and strata. For a full understanding of this phenomenon, the dominant

process, which is what ensured the basic conditions for reproduction, had to be identified; in capitalism, this was the process of circulation and, above all, the labour market. Finally, there were also non-economic legal/political and ideological processes, which ensured the secondary conditions needed for the reproduction of the social production process.

These authors argued that the social classes tended towards a greater or lesser degree of internal differentiation depending upon the type of capitalist development involved. For example, if the capitalist class was defined by ownership and possession and the working class by technical control and deforcement, then in the monopolistic phase of capitalism the former would be divided into owners and executives (possession) while in the latter, technical control would be separated from deforcement (manpower).

The proposed system of stratification can obviously refer to a class system and can apply to a given society the hypotheses derived from the theory of class relations, particularly those which attribute the dynamic of change to class struggle.

Authors such as Filgueira and Geneletti (1981) also dealt with the problem of social conflict in their analysis of the subject of stratification and mobility, but they saw it as essentially a distributive phenomenon. For them, "stratification refers, in a broad sense, to the way in which individuals have access to the available social goods" (1981, p. 2). These goods are primarily income, education, status, power and wealth. They see patterns of social stratification as being the most important causes and consequences of conflict among the individuals and groups in society, and define mobility as changes in distribution patterns for social goods. They distinguish between individual mobility, which is usually measured by the difference between the occupations of a father and son, and structural mobility, which arises out of an increase in some occupations as compared to others having a different status. This form of mobility, which would thus be generated by changes in the production structure, is the type that is of interest to these authors and constitutes the focus of their study.

Latin America has also been marked by a high degree of demographic mobility, primarily in the form of rural-urban migration, which has certainly led to changes in the occupational structure. Consequently, in order to analyse changes in the profile of that structure, Filgueira and Geneletti felt it was necessary to start out by looking at sectoral changes in the economy, establishing the classic distinctions

among the primary, secondary and tertiary sectors. The object was to see how these changes influenced the relative size of the socioeconomic strata making up the economically active population.

The stratification scheme developed by these authors has a number of different components, each of which includes various occupational groups. Their scheme is as follows:

(i) *Middle and upper strata in secondary and tertiary occupations*: white-collar workers in industry, commerce and services; senior personnel in industry, commerce and services; self-employed white-collar workers in commerce; and salespeople, office workers and other white-collar workers in industry, commerce and services.

(ii) *Lower stratum in secondary occupations*: wage-earners, self-employed workers and unpaid family workers.

(iii) *Lower stratum in tertiary occupations*: wage-earners, self-employed workers and unpaid family workers.

(iv) *Middle and upper strata in primary occupations*.

(v) *Lower stratum in primary occupations*: wage-earners, self-employed workers and unpaid family workers.

(vi) *Other*.

From the statistical analyses they prepared based on data up to 1970, Filgueira and Geneletti deduced that at the time they were writing, judging from the fissures being opened up by the emergence of a modern sector in the various areas of economic activity, they were witnessing the early signs of a redefinition of the structure of social strata. Despite the slow growth of this sector in terms of jobs, the authors pointed out the sociological importance of this change in that it was generating groups which could prove to be decisive in the formation and identification of some strata (especially those made up of executives, managers and supervisory personnel), thereby altering the overall composition of the middle classes. They also observed that, by the same token, a "workers' aristocracy" might emerge among the groups formed by manual workers.

These authors also noted that the lower middle strata and non-independent professionals were the groups that had grown the most (one out of every four employed persons belongs to these strata). An extremely important feature of these groups was the lack of correspondence between their job status and their educational status, since most of these people

were highly educated but earned low incomes. There was also a vast difference in status between people performing low-ranking non-manual jobs and those employed in high-ranking non-manual jobs. The former made up what might be described as a "sub-proletariat" of the middle class but none the less did not, in subjective terms, identify with the actual proletariat as such.

In analysing the behaviour of the middle classes, Filgueira and Geneletti found that the rapid expansion of these sectors, especially in the case of the bureaucracy, had been accompanied by an expansion of education that had redounded to their benefit. Most of the Latin American countries went through a phase of development of the various dimensions of the social modernization process (specifically, urbanization and education) which contributed to the integration of these groups. In view of these events, the authors affirmed the existence of "rules of deferred gratification" involving an acceptance of an unfavourable state of affairs in expectation of improvements in the future. They also warned, however, that if, over the long term, the possibilities for maintaining a reasonable balance between aspirations and their fulfilment should become exhausted, then tension would tend to build up to dangerous levels.

The status-related incongruities mentioned above were not only reflected in the behaviour of individuals and the tensions—either personal or collective—that might be generated; they also influenced other aspects, including the operational efficiency of the economic system. In the opinion of Filgueira and Geneletti, there was an increasingly sharp difference between existing levels and types of knowledge and those in demand in the job market. Evidence of this

was provided by the growing percentage of persons performing low-level administrative jobs who had a college education or of people holding generally unskilled jobs in service activities who had a secondary-level education. All this would seem to indicate that the prevailing development style was associated with an increasing underutilization of the available supply of human resources. Moreover, since the asynchrony between the development of the educational system and of the production structure would lead to a "devaluation of education", individuals would have to make increasingly large investments in education in order to attain the same occupational ranks and income levels.

In sum, the dominant model of structural mobility in the region has been marked by a substantial reduction in primary activities (especially in rural areas) in relative terms, by a stable situation with regard to low-level urban activities and by an expansion of the middle and upper strata. However, the manpower made available by the steady, steep decrease seen in the primary sector is mainly being absorbed by the tertiary sector, as the secondary sector's absorption capacity has apparently failed to keep pace with the reduction of the primary sector. There has been some social mobility in the region, but it has been limited because its dynamics have been obstructed. These authors feel that the existing form of social mobility "is only possible if it does not have a strong effect on the basic distribution of economic resources", and they posit the existence of a structural barrier to social mobility which they attribute to the structure of the existing pattern of occupational stratification and its distortions.

## II

### Description of the various social groups

Latin American sociology has not only established certain interpretive parameters regarding the social structure and stratification of the region. It has also produced numerous studies—some in the form of monographs, others having more ambitious theoretical aspirations—on specific social groups. In view of the volume of this literature, an exhaustive review cannot be undertaken here, however; the following

discussion will therefore be limited to a few examples that are considered to be significant. In addition, most of the studies that describe the characteristics of different groups are valid only for the time period in which they were done, so any attempt to make generalizations would be risky. Nevertheless, since our objective here is to point out changes and transformations, perceptions of a given group's characteristics

at one point in time are useful for comparisons with that group's perceived features at another point in time; this will provide us with at least some indication of the types of changes it has undergone.

### 1. The oligarchy and the elites

We will focus first on the so-called oligarchy, which is a term often used to describe groups within the upper strata that have traditionally wielded power.

One of the most detailed studies on these groups was done by Bourricaud (1969), and although it refers specifically to Peru, portions of its contents are broadly applicable. The oligarchy and its dominant position were based, according to Bourricaud, on an almost perfect system of patrimonialism whose defining characteristic was the control exercised by the "patrón", or boss, in rural areas on the *haciendas* and by the formation of "clienteles" in urban areas. It should be noted that Medina Echavarría also underscored the importance of the *hacienda* system in shaping a model of sociocultural conduct in Latin America and referred to the system of clientage as one of the particular modes of politico-social relations in the countries of the region. Both authors, too, highlight the importance of family connections for these groups. Bourricaud shows how the oligarchy used family connections to control broad sectors of the economy. From their base in agricultural activities, these families dominated a large portion of the region's foreign trade, exerted a powerful influence over some important media and diversified their interests by moving, for example, into construction. The oligarchy, for Bourricaud, was a group that gained a great deal of control over existing wealth, and its hallmark was the close relationship it managed to establish between economic power and political power.

Graciarena and Franco (1981) detected a change in the control of power, which they felt was shifting from the oligarchy to a new elite. These authors saw the expansion of the social spectrum from which persons were recruited to fill positions of power as a significant event in the Latin American countries. While the oligarchy was in power, this recruitment was primarily family-based since, typically, the oligarchy was composed of people who were related by blood or closely linked through their clienteles. In contrast, the members of the new groups taking up positions of power were drawn from a much more heterogeneous base. Nevertheless, most of them took

on similar, or at least compatible, ways of thinking and acting. This may be accounted for by the fact that they had a common socialization, shared social experience and similar ideologies.

These authors did not limit the category of elites to the upper strata of society. They saw this type of power as being held by a number of different segments; thus, there might be, for example, an entrepreneurial elite, a trade-union elite, a religious elite, a military elite or a civilian-technocrat elite, and complex relations might form among them. The complexity and heterogeneity of these elites stemmed from the heterogeneity of the economic structure itself. Within the production apparatus, a modern, dynamic core segment coexisted with large, archaic sectors of the economy. In addition, there would be a cluster of semi-modern firms that would be less efficient and have lower levels of productivity than the dynamic core group of firms, to which they were subordinate. Each of these types of firms—of differing degrees of modernity—had different patterns of social stratification, and this was the source of the growing complexity and incongruity of the social structure.

Hence, a distinction may be drawn between the oligarchy and these elites based on their differences in terms of the origins of their recruits and their power bases. The oligarchy's base was agricultural, although it had branched out from there to other parts of the economy. The elites, on the other hand, would not be divorced from the processes of modernization and industrialization nor would they be incompatible with the presence of large, influential middle classes. However, observed Graciarena (1967) in another study, the fact of the matter was that in Latin America the elites were oligarchic in nature; because of their mode of recruitment, the groups holding power basically have the defining characteristics of an elite, but their politics conform to oligarchic patterns.

### 2. Entrepreneurial sectors

Entrepreneurs are another group that has been studied a great deal, but most of the studies have focused on industrial entrepreneurs. This is understandable, in view of the importance which the emergence of a substantial industrial economy has had for the Latin American development process. Latin American industrial entrepreneurs have usually been characterized as having two different origins. One group of entrepreneurs is said to have arisen out of the social ascent of foreign immigrants while the

other is thought to have come from the economic differentiation of the old producer classes in the export-based period. Hence, the birth of industrial entrepreneurs as a group was a fragmented process, and from the very start they have been subject to severe limitations as regards development of an awareness of their own interests. None the less, in both cases the group that served as their ideological point of reference was the traditional oligarchy; this was, in some instances, because the traditional oligarchy was their source and, in others, because of a desire to imitate the oligarchy and thus secure the outward symbols of integration. As a rule, entrepreneurs have tended to associate themselves with those groups having the most economic and social power, and the configuration of an industrialization-promoting alliance –ideally, to be formed by industrial entrepreneurs, the middle class and workers– was therefore often no more than an aspiration of certain ideologues or was an incidental occurrence. The most important entrepreneurs, in particular, identified more closely with the interests of the groups wielding economic and social power.

Another quite significant event –which played a role in the above-mentioned developments– was the formation, starting long before, of large economic conglomerates and holding companies. These conglomerates were involved in all sorts of activities and provided a close link between industry and other sectors (such as banking, for example) that were controlled by more traditional groups.

Furthermore, especially in the case of large enterprises, the degree of external dependence –even if the firm's activities targeted the domestic market– was considerable and was manifested in their financial affairs, technology and even their capital stock. Thus the interrelation of interests tended to favour anything that made that connection possible and the interests that made it viable.

Of course, small and medium-scale entrepreneurs were an important group as well. Although at times they behaved somewhat antagonistically towards large entrepreneurs, more often than not they were in a markedly subordinate position to the latter, which prevented them from carrying their conflicts to an extreme. Moreover, when they were not in a position to meet their employees' demands, they sought to form alliances with the more powerful groups in order to contain such pressures. What is more, small and medium-scale industry tended to be severely affected during downswings in the economic cycle and,

for a number of reasons, their performance in terms of economic efficiency was not encouraging. According to a study conducted in Chile by G. Campero (1984), between 1967 and 1979 the number of small-scale industrial establishments fell by 10.5% and the value added by this sector dropped by 27.6%.

Sociologists studying the behaviour of entrepreneurs and their influence on the modalities of the development process were particularly interested in analysing this group's creativity, its capacity for innovation and its risk-taking skills, among other characteristics. Many such studies found that, except in a limited number of cases and under very special sets of circumstances, entrepreneurs did not usually show a willingness to assume the risk of investing in new companies. For the most part, they were more inclined to use the advantages offered by the market to their benefit and, for that reason, in many cases their behaviour was more like the modes of conduct associated with merchants and financiers. Their frequent disinterest in innovation may be accounted for by the fact that many of them were operating in captive markets. Many of the studies conducted on this subject have found that, during extended periods of time, entrepreneurs' behaviour was marked by a tendency to adapt rather than to opt for change. A tendency was observed on the part of entrepreneurs to confine themselves to the demand possibilities associated with a given social structure. Consequently, the production structure mirrored socially-structured demand patterns.

### 3. The middle class

Another special concern of Latin American sociology, in addition to the role of entrepreneurs in the development process, has been the behaviour of the middle classes, taking into account their role in the political process and the modernization process in general. In the above-cited study by Filgueira and Geneletti, special attention was devoted to these groups because the authors felt that the change in the percentage of the total economically active population represented by the middle class was a good indicator of changes in social stratification patterns as a whole, as well as being a key factor in understanding social mobility. In view of this group's heterogeneity and the breadth of the term "middle class", their research focused on identifying the strata making up the various areas of activity, since their thesis was that the growth of the middle class was linked to

changes in the composition of the economically active population by area of activity.

Many students of the subject have maintained that in most of the Latin American countries the expansion of the middle class has outstripped the development of the forces of production. Among the causes of this hypertrophy, they cite the convergence of a series of processes, such as urbanization, the development of education and bureaucratization. The majority view is that the fundamental factor has been the expansion of the State apparatus.

Authors such as Ratinoff (1967) have attempted to divide the historical evolution of these sectors into various stages based, in particular, on the types of behaviour observed in each. Thus, they have defined an ascending phase, marked by a successful effort to win the working classes' support for the political proposals of the middle class; by a substantial institution-building capacity; by the formulation of policies and ideologies conducive to State intervention; and by the introduction of changes in the economic, social, cultural and political spheres. The most salient feature of the second phase, which has been called the "commitment phase", would then be the aim of guaranteeing the agendas already on the table.

Graciarena (1967) also postulates the existence of a long historical cycle as part of his understanding of the middle class, in which the pivotal element is its degree of autonomy from other groups. According to this author, the extent of its autonomy was extremely limited in the early days of Latin American society, following independence; later, during the early decades of the twentieth century, it started to increase until, at different points in time depending on the country, it reached its acme. Thereafter the middle class's autonomy began to wane, and by the time Graciarena wrote his study, it was once again at a low ebb.

Graciarena distinguishes two main groups in this process. The first, the "residual middle classes", formed during the colonial period and the nineteenth century in close association with the upper classes and has exhibited high levels of structural dependence and status in relation to them. This group had strong ties to the traditional economy and has been in decline but has not lost all its influence, and is now primarily linked to certain sectors of the government bureaucracy, such as the judiciary, the diplomatic service and some levels of education. Its behaviour is guided by the values associated with the upper class. The second group is the "emerging middle classes".

This group is a product of economic development, and its main base is found in the modern sector of the economy: manufacturing, commerce and services. This group has had greater autonomy than the first and has promoted economic development, which has brought it into confrontation with the oligarchy and the traditional middle classes. This conflict, says Graciarena, was a major one and constituted a milestone in the history of Latin America, although it has subsequently tended to subside.

Many authors contend that a large part of the middle class has lived almost as parasites, a situation which has been promoted by systems that used or still use State resources to add unnecessary employees to the bureaucracy's payrolls, that offered cheap credit to companies and professionals as well as low-priced housing and consumer loans, that advocated public welfare policies which primarily benefited these sectors, and that promoted other, similar measures. When they became aware of their privileged position, these groups—according to the experts—strove to defend a status quo which worked to their benefit. They are also said to carry significant weight in existing power structures due to their numbers and their social influence, which is augmented by the role played in the State apparatus by technocrats and bureaucrats drawn from their ranks. Because of all this, the middle class is said to have helped shape some of the development styles that have characterized the region. Nevertheless, some authors realize that, since these sectors have attained relatively high educational levels, which in practical terms translates into professional training and skills, they have contributed to the development of a technical rationality that has had a considerable influence in terms of levels of economic productivity.

The question of the middle classes' internal heterogeneity has captured the attention of scholars, who have used various criteria for ascertaining their differences. Filgueira and Geneletti, for example, differentiate between those who perform high-status and low-status non-manual jobs. The latter category appears to have expanded more, which would imply some degree of "proletarianization" of these strata, although this does not necessarily mean that their members subjectively identify with working-class sectors. Along with the growth of a relatively impoverished segment of the middle class, however, a "modern" middle class has also been forming. The question then arises as to whether this growth can be sustained and what conditions are needed in order for

this to happen in each country. Regardless of the answers to these questions, it is a fact that most experts agree about the importance of the technocratic groups which have links to these strata. Development itself, they assert, combined with the demonstration effect of the advanced countries in the international system, has made the creation of a technically sophisticated structure necessary. By virtue of the position held by these groups, they can exert a great deal of influence over certain aspects of the development style. O'Donnell (1972), for example, says that senior technocrats in major institutions have certain aspects of their background and socialization in common and establish linkages among themselves which lead to mutual recognition and similar types of conduct, regardless of the particular sector in which they are involved. Their behaviour would appear to be based on a certain definition of what is rational, appropriate and technically effective. Thinking, apparently, about the above-mentioned groups, Fernandes (1968) states that the middle classes are the standard-bearers of ultramodernity and that it is in this sphere that they have the best opportunities for asserting their own worth in the market; modernization incorporates those interests and forms of action that are specific to them as a class. Changes in the weight carried by the various sectors within the middle class have implications for the ideology of the entire sector. According to Graciarena (1967), the middle class has abandoned its original ideological stances and has therefore reduced its chances of influencing the other classes. He feels that the middle classes' power has always been based on an expansion of State control and that, by accepting ideologies that delegitimize State intervention, it has undermined its own power base, thereby leaving the actual direction or supervision of economic processes in the hands of big business.

#### 4. The workers

The available data indicate that between 1961 and 1980 the strata making up the working class expanded in almost all the countries. However, in comparison with the rest of the economically active population, this sector was still not large enough to be a decisive factor, and its size varied markedly from one country to another. For example, in Argentina manual workers represented 27.5% of the economically active population; in Chile, the figure was 25%, and it was no more than 19% in Venezuela and

Panama, 17.5% in Mexico, 16% in Colombia, 15% in Brazil and less than 15% in Peru.

The working class is also internally heterogeneous, but its variability is not due so much to differences in the types of occupations or activities performed, as in the case of the middle class, as it is to other factors. The first difference identified by researchers was the existence of an "old" and a "new" working class. The "new" working class apparently was formed as a result of internal migration and the rapid expansion of the manufacturing sector during the import-substitution stage. Most studies on the subject cast the "old" working class as a type of theoretical model which is actually more valid for the countries along Latin America's Atlantic coastline (specifically Brazil, Uruguay and Argentina) and particularly for cities in which some sort of manufacturing activity had been pursued on a substantial scale prior to the import-substitution phase. Hence, researchers postulated that the working class included a large contingent of immigrants from Europe—particularly Italians, Spaniards and Portuguese—who had something of a working-class tradition and a certain skill level, although they were associated with some artisanal traits and ideologies of the labour movement in their home countries. Subsequent studies amended many of these assumptions. First it was pointed out that this experience—as indicated earlier—corresponded only to some countries, and that even in cases where the number of immigrants from Europe had indeed been considerable, the majority of those immigrants did not necessarily have experience as manual workers, and emphasis was placed on the significance of the immigrants' rural backgrounds. It was made clear that much of what had been said in earlier studies referred to relatively small groups which had been in leadership positions and that the traits of this elite leadership were being mistaken for the characteristics of the whole group. The typical set of features attributed to the "old" working class were used to mark a contrast with the characteristics of the new contingents formed by internal migration and the expansion of the manufacturing sector. Whether or not the comparison was valid, however, the description of the new breed of workers was of some value in its own right.

These workers' most frequently cited traits were their low educational and skill levels, since their rural origins had not afforded them any semi-industrial experience, nor were they skilled craftsmen. Their origins were initially considered to be one of the key

determinants of their conduct and characteristics, but it was later demonstrated that in some countries –one example being Chile, according to Gurrieri (1968)– this blanket statement needed to be analysed with care, inasmuch as rural migrants also had some experience in the admittedly smaller cities of the generally rural provinces. Another interesting point made by Gurrieri is that, at least in Chile, the formation of working-class sectors through migration was not a novel phenomenon; indeed, migration was an integral part of the history of the working class's origins. Nevertheless, for the Latin American countries in general, internal migration came to be a large-scale phenomenon following the Second World War, and new contingents of migrants made their appearance at the time that mass consumption patterns were spreading, which influenced the type of demand that was generated. These people's incorporation into urban life, in terms of what that meant at the time (e.g., access to housing, education and social benefits), overshadowed more specifically labour-related demands.

These changes affected not only workers but society as a whole. The pre-existing norms and standards were no longer as valid, and this had an impact on workers. The formation of a class identity still appeared to be a difficult venture, especially as regarded the definition of shared interests, and what solidarity was to be observed was primarily focused on primary groups. All of this played a part in generating what appeared to be the most common form of political conduct, which was the formation of available and easily manipulated masses.

The statements that had been made about the working class were very broad generalizations, and a number of important differences remained to be established. Di Tella (1964) identified two major strata –a lower and an upper one– within the working class. The lower stratum was most like the “new” workers mentioned earlier by virtue of its members' low cultural and skill levels. Di Tella also noted their tendency towards an “authoritarian personality”. Their social views were somewhat confused and they exhibited an inclination to participate in mass movements which gave them the illusion of direct participation that was not being brokered by any organization. The upper stratum was formed by more highly educated and skilled individuals who would therefore often have an opportunity to move up to leadership positions and thus increase their chances (as individuals and for their families as a unit) of

social mobility. This mobility would bring them closer to the middle class, whose value systems they internalized. The social distance separating them from the lower stratum of workers would cause them to interpret the interests of the working class based on their own situations; their identification with middle-class values hindered communication with the rest of the working class and hampered a full understanding of its problems. Thus, the fact of the matter is that a clearly-delineated class identity was not in evidence among either the lower or the upper stratum.

The distinction between skilled and unskilled workers came to be an important element in analyses of the sector's internal stratification. A number of studies indicated that in Sao Paulo (one of the most industrialized cities in Brazil), for example, unskilled workers saw no improvement in their living conditions either during the 1970s or thereafter, in contrast to the situation for skilled workers, whose real wages rose as well. Moreover, when wages were declining, the decrease for unskilled workers was much sharper. The distance separating the unskilled mass of workers from the better-placed industrial workers was thought to have influenced the direction taken by the trade union movement in many cases and even to have had some political repercussions. The notion arose that the two strata did not share the same values or interests and that the more skilled group would tend to be perceived as a privileged elite.

## 5. The *campesinos*

The existing analyses of the *campesinos* in Latin America have been strongly influenced by the anthropological approaches taken to the description of this sector's structure and the study of its members' behavioural traits. Furthermore, many of the early studies were conducted by researchers from the United States, and this is reflected even in the terminology used. Redfield (1956), for example, in considering small isolated communities, made a distinction between “peasants” and “farmers”. He used the term “peasant” to refer to those who had a measure of control over the land that permitted them –and this is the salient point– to maintain and even develop a traditional lifestyle in common; agriculture was the foundation for this way of life and was not regarded primarily as an investment, with a portion of output being sold in the market, or as a business concern. “Farmers”, on the other hand, had an

entrepreneurial outlook, and agriculture was their business.

Some Latin American researchers, such as Quijano (1967), have defined the *campesinos* in ways that emphasize the power relations of which they are a part. The *campesinos*, they assert, are the members of the rural population who belong to economically and socially dominated strata, regardless of the specific function they may perform; they may include day labourers, settlers and sharecroppers, owners of very small holdings, small-scale merchants, craftsmen, students, etc. This definition does not mean that these differences should be ignored; it simply delimits a broad, inclusive category.

Landesberger (1969) attempted to summarize the elements shared by the various definitions of the *campesinos* that have been formulated, with the following results: *campesinos* are "rural cultivators", i.e., people having links to the working of the land or who are very close to it; they have a dual orientation towards the family and the market, but they do not see themselves as somebody who is managing a business in order to get the most out of it; their behaviour is in reference to a community, generally a limited group of families who share the same standards and values and who occupy a subordinate position in a hierarchical economic and political structure. For Landesberger himself, however, the essential point is that they are rural cultivators in low-ranking political and economic positions, and their specific characteristics must be defined empirically in each particular case.

Stinchcombe (1961-1962), on the other hand, attempted to set up a differentiated typology of *campesinos* according to the types of agricultural concerns to which they were linked. This typology encompasses a number of different categories based on decision-making power in regard to production and the distribution of benefits; on land values; on whether the landowner exercises police powers over his workers or is their relative; on the amount of capital required to run the business, excluding the land; and on the enterprise's degree of technical organization. Based on these criteria, Stinchcombe identified various types of agricultural concerns. One was the *hacienda*, which is part of a system that retains much of its feudal, pre-commercial character and involves a dual distribution of land. A portion of the land is divided into small plots that are in the hands of the *campesinos*, who practice subsistence

farming on them; the rest is the landowner's, and its output is marketed. This land is farmed by the above-mentioned *campesinos*, who often work the land on the basis of common-law obligations. The prices of both labour and land are low, and the landholder's power is almost absolute; output is not plentiful, and the level of efficiency is very low. The form of production denotes the separation that exists between the landholder and the *campesinos*. The former is frequently an absentee landlord who pursues political activities in the city; the peasants, on the other hand, live on the fringes of that world in an apathetic state marked by backward conditions and a lack of political rights.

Another type of agricultural concern is the plantation. This type of enterprise is based on large capitalist holdings devoted to crops which generally take a number of years before they are ready for harvesting and require a large amount of labour; they may also require other types of long-term investments such as, for example, investments in machinery. They are labour-intensive and the demand for manpower is often seasonal. Stinchcombe asserts that the dominant class in this type of enterprise takes care to prevent the establishment of small landholdings and will even strive to suppress them if they do make an appearance. Technical control, he says, is in the hands of the above-mentioned social group.

The *estancia*, or ranch, is defined by this author as a capitalist enterprise which keeps livestock or practices extensive farming and whose manpower is primarily provided by wage-earners. The land itself is of little commercial value and the workforce is low-priced, fluctuating and mobile, has few family ties and lives in group camps.

Another category, Stinchcombe adds, is that of *tenant farming*. In this case, the actual landowner is a rentier who gives over his land in exchange for a payment that may be made in cash or in kind, or in a combination of the two. The land used for such ventures is very productive and has a high market value. Its cultivation is labour intensive, but largely unmechanized, and the type of manpower used—apart from that of family members—is inexpensive. The crop cycle is one year or less in duration, and no appreciable economies of scale are attained for factors other than labour. Social contact between these landowners and tenant farmers is extremely limited, and the two groups therefore have very different lifestyles.

The last category defined by Stinchcombe is the *small family farm*. The costs incurred on such owner-operated farms are usually fairly stable; these farmers' most serious types of problems have to do with the marketing of their output, and they often have disputes with middlemen, merchants and creditors. Communication within this group is very limited.

The above studies on the *campesinos* of the region not only described the differences within this sector and, thus, the existing rural structure; they also—especially in the 1960s and early 1970s—sought to provide the basic elements needed to explain the *campesino* movements that were triggered by the agrarian reforms undertaken in many countries. The aim was to gain an understanding of where these movements were headed and of the new types of structures they might engender, bearing in mind the *campesinos'* traditional ties to the land. This being the case, research efforts focused chiefly on the traits of the various *campesino* movements considered to be significant at that time.

## 6. Marginality and the informal sector

Marginality was the main concept used in the first studies on those people whom we now usually group under the heading of the "informal sector".

As a result of mass rural-urban migration, beginning in 1950 a type of population cluster began to appear in the large cities which was characterized by the installation of makeshift housing on land that was spontaneously "taken over" by these new inhabitants. Studies of these urban settlements found that they often included not only rural migrants, but people who had been pushed out of the cities themselves, as well. Concern about these segments of the population soon brought to light the fact that other groups, too, such as the inhabitants of urban slums and tenements—some of whom had been in the cities for much longer—were also living under similar substandard conditions. What was so striking, however, was the widespread nature and massive scale of the new phenomenon.

Initial concern about the economic marginality of these groups soon sparked concern about their social status and characteristics. Given the importance attributed to the phenomenon of migration, the discussion of this issue revolved around the persistence in such groups of traits associated with rural areas (from where it was supposed that they came), their ability to adapt to new conditions and their manner of

doing so. At first, the tendency was to regard the situation of these groups as a natural part of their transition from rural to urban life. However some authors, such as J. Matos-Mar, for example, contended that in cases of mass migration, such as in Peru, what was actually taking place was a ruralization of urban areas, an idea he summarized quite concisely in the title of one of his essays, *La Serranización de Lima* ["The Sierra comes to Lima"]. O. Lewis' classic studies, too, indicated that, rather than finding a place for themselves in urban life, these groups tended to form what was actually a "culture of poverty".

In a ground-breaking study on marginal communities in Santiago, Chile, Rosenblüth (1963) brought to light how little these groups shared in the benefits of economic development, how restricted their access was to the institutions of the nation-State and, as a result, how they suffered from political, economic and social marginality. The dimension of marginality took on a broader meaning than its purely economic sense. In addition, studies conducted by the Economic and Social Development Centre of Latin America (DESAL) indicated that these groups of squatters tended not to share society's standards and values, their participation in the labour force was perpetually unstable, they had no access to important decision-making opportunities and did not play a real role in the solution of their own problems. These types of studies led to more specific concerns about the economic position of these groups. In particular, some authors who were more open to approaches of a Marxist cast began a discussion about the economic function of these groups. J. Num and others devised the category of "reserve army", although in succeeding writings—largely as a result of a controversy in which, in addition to those already mentioned, F. H. Cardoso also took part—an attempt was made to adjust the concept of "reserve armies" to fit the conditions peculiar to dependent economies such as those of Latin America. Critics of this idea emphasized these groups' position as a "surplus population" in relation to the economy and warned about the existing economic system's lack of absorption capacity. The idea was advanced that the very process of development and modernization in Latin America had the potential to disrupt pre-existing forms of economic activity but lacked the capacity to provide productive ways of absorbing those who were displaced.

It is important to note that when studies began to be conducted on the ways in which these groups

could become integrated into the economy, those early assumptions –according to which marginality was a phase in the transition from rural to urban life and these groups would eventually take up a “normal” role in the latter– were abandoned. Attention shifted back to the characteristics of the economic system and its drawbacks. Many subsequent writings were linked to studies by the Regional Employment Programme for Latin America and the Caribbean (PREALC) which made the connection between the idea of inequality and the concept of the informal economy. Tokman (1979) spoke of the inability of the modern sector of the economy to absorb manpower quickly enough and, at the same time, underscored the heterogeneity of the production structure. This heterogeneity generated differentiated labour markets, and many of the new additions to the urban labour force, regardless of whether their source was natural population growth or migration, were unable to find work in the modern sector. These new entrants’ job search was therefore directed towards other production strata, where the labour market operated differently and the demand for labour was not determined by the accumulation process within the sector; instead, employment levels were dictated by the amount of surplus labour and the opportunities offered by the market to produce or sell something that would provide some income.

Tokman asserts that there are essentially two types of labour markets: a formal market and an informal one. In the formal labour market, jobs are found within organized companies and in the personal services utilized by the higher-income strata. These jobs are obtained by the more qualified people with the most experience in each profession. The informal labour market, for its part, is composed of self-employed workers, people who work in small firms, and those who render personal services at a low level of productivity. He adds that the predominant form of labour in this type of market is owner-operator forms of self-employment. Largely because of this fact, wages are not the most common form of remuneration, and the State takes virtually no

regulatory action, in terms of either legislation or enforcement, regarding labour relations in this sector.

In the above-mentioned study Tokman says that, these definitions notwithstanding, it is difficult to ascertain the size of the informal sector by empirical means. There are a number of other ways of measuring it, however. One focuses on job positions, and includes self-employed workers, people who render domestic services and employees in production units composed of fewer than four people. The second option looks at income levels, and includes all persons whose incomes are below an externally-determined threshold. The third option categorizes all those who do not pay into the social security system –except professionals and employees in establishments having over five people– as informal workers; domestic servants would also be included in this group. Despite the difficulties involved in its measurement, around 1975 it was calculated, based on existing studies of various cities in the region, that the informal sector employed between 46% and 50% of the urban labour force. As regards its composition, research findings indicated that women represented a larger percentage of the workforce in the informal sector than in any other sector of the economy, even when domestic servants were not included. It was also found that the youngest and oldest workers, along with the least educated, were concentrated in the informal sector. In regard to types of activities, between approximately 80% and 85% of persons working in this sector were engaged in commerce, professional services and what are classified as “industrial” activities (e.g., shoemaking, sewing of ready-made garments and food preparation). An important point made by these studies is that peddlers or itinerant street vendors, who, as noted by Tokman, are the most tangible symbol of the informal sector for many people, actually account for only 10% or less of employment in the informal sector in most of the countries, whereas “industrial” activities represent 15% of total employment in this sector in such countries as Mexico, El Salvador and Paraguay.

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# Socioeconomic *structure and* collective behaviour

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This article provides an overview of a number of changes that have taken place in the region's economy, together with their effects in terms of its social stratification, and analyses the different social sectors' options for political action. A series of economic changes have altered both the traditional heterogeneity of the Latin American economy and the relative weight of its various sectors; this is reflected, for example, in the heightened importance of agribusiness and the reciprocal penetration of the services and production sectors. Today a generic distinction between "incorporated" and "excluded" social groups is generally accepted, but these categories are not only imprecise and lack homogeneity; they also underestimate the relations that actually exist between the two, such as those frequently observed to have been established between the formal and informal sectors via subcontracting practices. As the heterogeneity of the regional economy changes, new sectors may come to exert an influence over social and political processes. This points up the need to review the conditions for collective action afforded by a capacity for organizing and broadening the base for a community of interests, whether as a means of corporate defence or as a way of presenting those interests as an agenda for society.

# I

## Present economic and social structures

Structural heterogeneity is a permanent trait of the Latin American economies, but economic transformations have gradually altered the nature of that heterogeneity and have changed the countries' patterns of social stratification in very important ways. A roughly-drawn distinction between people who have been "incorporated" into the economy and society and people who have been "excluded" from those spheres can certainly be postulated, but the two categories need to be clearly defined, since the former's status as "participants" does not prevent them from displaying sharp differences among themselves, and those who are "excluded" do not form a homogeneous group either. The important point is that significant relationships exist between the two sectors; they do not constitute categories which function under different systems without reference to one another. In specific terms, this form of exclusion tends to be associated with membership in the so-called informal sector, but the people classified as belonging to this sector because of the type of work relations they establish (ill-defined contracts, an absence of social benefits, a lack of organization) often do take part in what we generally classify as modern or "formal" activities via subcontracting mechanisms. This is the case, for example, with peddlers, or "itinerant vendors", who are actually distributing products made by transnational corporations. Thus, if categories such as "incorporated" and "excluded" are to be used, they need to be carefully defined, since otherwise they pose a theoretical problem similar to that which arises when we postulate the existence of "structural dualism". The differences separating the two therefore need to be clearly delineated, as do the nature, the mutually-agreed terms and the dynamics of the relationships existing between them.

■ This article is based on a study on social structures and development styles in Latin America ("Estructura social y estilo de desarrollo en América Latina") which was prepared in conjunction with Enzo Faletto for the ECLAC Social Development Division.

Another factor to be borne in mind is the changes taking place in the relationships among the various economic activities (i.e., the manufacturing, agricultural and services sectors). The classic system of categorizing them into primary, secondary and tertiary sectors has often been coupled with the idea of there being a certain sequence in the development of each. In Latin America, it has often been thought that economic trends were sometimes departing from this growth pattern, and that these departures signalled the presence of distortions in the region's social structure and stratification. The fact of the matter is that changes in the relationships among these sectors have markedly altered, for example, the importance of agribusiness and the implications of the mutual penetration of the services and production sectors (primarily in such activities as finance and marketing and, more recently, communications and informatics). Shortcomings in cross-sectoral linkages within the region are still appreciable; but in those cases where interconnections have been formed, changes have also occurred in the pattern of social stratification which do not fit in with the traditional classification systems. In the following pages an attempt will be made to illustrate –admittedly in a very general way– some of the problems outlined above with a view to contributing to future analyses of these new characteristics of the region's social structure and stratification. A suitable starting point for an analysis of the relationship between the economic sectors and social structure is Rubén Kaztman's essay on sectoral transformations in employment in Latin America (Kaztman, 1984).

### 1. The manufacturing sector

A number of authors have formulated definitions of existing forms of industrial organization. Touraine (1989), for example, says that in many countries four different levels of industrial organization can be distinguished: dominant industries, which are often engaged in extractive activities and sometimes provide more than half of a country's exports (copper in

Chile, tin in Bolivia, oil in Venezuela and Ecuador); large-scale modern industries, which are usually owned either by the government or by foreign interests; domestic industries and the construction industry, which are controlled by private investors of the country in question; and the informal sector, which is made up of small, low-productivity units. Other authors classify companies chiefly by size (large, medium and small companies and microenterprises), by the type of product (commodities, capital goods, consumer durables, consumer non-durables), or by reference to many other criteria. Of course, each of these classifications is related to the specific objective of the study in question. These various ways of classifying business enterprises have a bearing on studies concerning social stratification because, more often than not, those who are conducting such studies have to make use of the existing classifications. Thus, we need to recognize the fact that, if the most decisive feature of stratification in Latin America is the social heterogeneity generated by its heterogeneous economic structure, then the way in which we are to draw those distinctions does indeed make a difference.

Perhaps the first consideration is the much-discussed imitative pattern of consumption and of some production structures. Fajnzylber (1983) saw a morphological affinity between the industrialization process in Latin America and in the advanced countries: Latin America's industrial growth had been very rapid (even faster than in some developed countries, in fact), the alteration of its sectoral structure fitted in with that of the more advanced countries, and the increase in its productivity was considerable and was associated with the most dynamic sectors. This similarity between a large part of the region's industrial sector and the advanced countries did not, however, extend to the production base of the economy as a whole, but was instead concentrated primarily in production activities or product lines capable of finding a niche in the international market.

An examination of the current situation reveals that in some cases the industrial sector has established strong linkages with other sectors, but such tie-ins have not been as widespread or as positive as one would hope; for example, if we look at the connection between manufacturing and the agricultural sector, we find that most agricultural machinery, pesticides, fertilizers and other manufactured inputs are imported, and that, as a rule, manufacturing industries have not managed to make full use of the potential market represented by agriculture. It is important

to note that where linkages between manufacturing and agriculture do exist, the distortions in the former's production pattern are transmitted to the latter and influence the existing forms of social stratification, which, as noted earlier, are associated with structural heterogeneity. On the other hand, it is doubtful whether, even if the existing industrial pattern did expand its linkages with the agricultural sector, it would work a change in the latter sector as a whole. Since the expansion of the manufacturing sector has been accomplished primarily through the addition of new product lines rather than through an increase in the scale of production for existing goods, there is reason to believe that increases in production will tend to be oriented mainly towards raising the consumption levels of middle- and upper-income social groups.

The situation as regards the relationship between the manufacturing and services sectors (e.g., in the financial market) is somewhat similar. The activities in which transnational corporations predominate are generally the ones that are growing the fastest, display a strong ability to secure external backing and afford high rates of return. It is therefore not surprising that they are more attractive to investors in the financial sector, including its domestic segment. Indeed, it is interesting to note that transnational corporations are obtaining a growing share of their financing from sources within the host country.

Another significant factor is the linking of large-scale enterprises through, *inter alia*, the formation of large holding companies. De Oliveira (1989) cites the Brazilian petrochemical complex of Bahia as an illustration of this type of linkage: the holding company owns stock in 13 firms, is directly involved in the management of 10 companies now in operation and 7 more that are starting up, and indirectly in another 18 firms in the chemical, petrochemical, alcohol-chemical and pharmaceutical industries.

Large holding companies have also been formed in many other countries. These companies' basis for capital accumulation is no longer chiefly found in the financial sector—as it was until quite recently—but rather in the production of tradables for the international market (agricultural, mining and manufactured goods). A large portion of the stock in these holding companies is often held by transnationals, but the scope of external interests goes far beyond that. De Oliveira (1989) states that in Brazil there is virtually no sector or large firm that is not using some foreign patent, trademark, technology or production process.

There is also a great deal of foreign capital invested in the production of consumer durables.

The presence of foreign firms is not unique to Latin America (Fajnzylber, 1983), but the scale of that presence may be, as well as its imitative production structures and the acceptance of such a presence in activities that do not necessarily entail a high level of technological complexity. In policy-making in this connection, there is a conspicuous absence of participation by domestic groups that could play an influential role in terms of public action and in modifying the behaviour of national firms, both public and private.

This relative absence of local initiative is particularly glaring in the area of decision-making regarding available technological options. Entrepreneurs are primarily guided by microeconomic considerations, and the technologies they choose are therefore similar to those used by the leading firms that are determining the direction of industrial expansion. Since the latter are usually transnational corporations, the technological profile that ultimately emerges corresponds more closely to these firms' growth and diversification goals than to macroeconomic objectives such as, for example, a long-term increase in employment. Moreover, the growth path of transnational corporations often does not go hand in hand with that of the host country's production structure as a whole. Not only do transnationals tend to grow more than their national counterparts; the type of products associated with these corporations tend to expand more rapidly than do goods produced by national firms for the domestic market. Thus, the heterogeneity that generates sharp inequalities in the region's social structure and stratification tends to be heightened by this process.

It is generally believed that large firms are modern and use sophisticated technology while small firms are more traditional. In some instances, however, large companies are the ones using traditional technologies while small enterprises are utilizing advanced technology. What is more, the modernity of a company cannot be measured solely by the technology—when defined as production equipment and machinery—that it uses; the way in which its production activities are organized, the dynamism of the economic relations it establishes and the role it plays in industrial development must also be taken into consideration.

Given the above, it follows that capital goods industries are in the best position to transmit

and disseminate technological development and, hence, that Latin America's weakness in the area of technology is associated with the backwardness of this branch of industry.

Manufacturing companies have been classified on the basis of a variety of criteria. One such criterion has been the size of the company as measured by the number of employees. This criterion not only involves a numerical difference; it also implies differing levels of operational complexity and different forms of organization and ownership. Each of the component groups within a company—owners, entrepreneurs, executives, administrative personnel, various types of workers—establishes relationships with the others that set it apart from similar groups in other types of firms. This generates a greater degree of heterogeneity and influences the social stratification and behaviour of the various groups.

Based on this criterion, Castillo and Cortellese (1988) use the following definitions in reference to Latin America:

(i) Large firms are those which employ over 100 people, exhibit a relatively large-scale industrial structure, have a diversified operational scheme that is organized into specific units (e.g., different units for various types of management functions, administration, finance, sales, production, maintenance, development, etc.), base the organization of their workforce on a division of labour, have a generally complex ownership structure, use a strategy oriented towards an oligopolistic structure and imperfect competition, and target their activities for international as well as domestic markets.

(ii) Medium-scale firms employ between 50 and 99 individuals; their strategy is aimed at increasing their scale of production and expanding their markets; executive duties are generally performed by more than one person; their organizational scheme is less complex than that of large firms but more so than the schemes used by small companies; and they tend to maintain a certain degree of flexibility in their production activities.

(iii) Small firms employ between 10 and 19 people; they are usually owned either by an individual or a simple partnership, and the owner generally performs all or most management tasks; their capital/labour ratio is low, but may vary depending upon the line of business in question; they have a high degree of technological flexibility; their markets are nearby, although there are exceptions in this respect; and their business objective is generally not a type of

growth that would entail a more complex organization or a larger scale of production.

(iv) "Informal" firms have a rudimentary organizational scheme, lack a clearly-delineated division of labour as well as any well-defined division of ownership of the means of production, are based on very little capital and require few skills of their employees.

The relative shares of total manufacturing employment accounted for by each of these different types of companies vary from one country to the next.

With respect to the relative position of manufacturing-sector workers, Wolfe (1990) has stated that during the 1980s these workers were subject to even more severe disturbances than middle-income wage-earners were. These effects were the result of a combination of actual decreases in income and purchasing power and extreme insecurity regarding these workers' place in society and their future prospects. The decrease in their wages amounted to as much as 50% in some cases, and at some points in time, the number of workers employed in the manufacturing sector tended to remain constant or even to decline while the urban labour force as a whole was growing steadily. The various types of manufacturing industries and firms exhibited considerable differences not only in wages but also in terms of working conditions, labour relations, legally-mandated benefits and access to social security and welfare systems.

Most of the researchers who have studied the labour movement and the unions have used skill levels and degrees of specialization—which often are closely associated with the type of industry in which workers are employed—as criteria for classifying workers; but the nature of the company in which they work (e.g., whether it is a transnational corporation, an oligopoly, a firm with a high or low degree of organizational complexity, etc.) is also a decisive factor in terms of their differentiation. These two bases for worker differentiation give rise to sharply differing labour-movement orientations and courses of trade-union action. Nevertheless, in broad terms, Wolfe (1990) has emphasized the fact that during the 1980s most of the trade unions became less able to defend the interests of their members, and their capacity for influencing national policy was greatly diminished.

## 2. The agricultural sector

The rural population in Latin America has become a minority, although its size has generally remained

constant in terms of absolute numbers. It is more integrated into the countries' societies and economies than in the past, but this integration has, for the most part, taken place on very disadvantageous terms and has not been complete (Wolfe, 1990).

López Cordovez (1982) indicates that the profile of the agricultural sector differs from one country to another, ranging from highly prominent to quite limited. Be that as it may, he also points out that, according to national accounts, between 1970 and 1980 the gross domestic product (GDP) of the region's agricultural sector climbed by 3.5% per year, as compared to an increase of 5.6% in total GDP. During the same period, agriculture's share of total GDP slipped from 14% to 11.4%, while the agricultural workforce's share in total employment shrank from 42.1% to 36.2%. These decreases were coupled with a number of shortcomings in the following areas identified by López Cordovez: (i) the potential food demand of Latin American societies, with around 4.5 million undernourished people (food production expanded by 0.8% per year while effective demand grew by 3.6% per year); (ii) the production potential of the region's agricultural sector, inasmuch as only slightly more than a quarter of the land suitable for agriculture was actually farmed; (iii) requirements in respect of agricultural exports; and (iv) the growth rate of production.

Social inequality within the agricultural sector continues to be a cause of concern. The United Nations Food and Agriculture Organization (FAO) has calculated that in 1973, 70% of the farm population in Latin America was living under subsistence conditions, that 45 million agricultural wage-earners and 40 million small landowners were together earning about 35% of total agricultural income, and that their average per capita income was an estimated US\$115 (in 1970 dollars) per year. Medium-scale agricultural producers represented 28% of the farm population and 43% of the sector's economic units. Large landowners represented 2% of the farm population, owned 22% of the economic units and had an estimated income of US\$2 560 (again, in 1970 dollars) per year. Another part of this picture was a still very concentrated pattern of land access, with large landowners occupying 47% of the land under cultivation and *campesinos* just 2.5%.

If a distinction is drawn between agribusiness and the agriculture practised by small farmers, we see that as of the early 1970s, the differences between the two were significant.

During the past few decades, traditional agriculture has been in decline in Latin America. According to Gomes and Pérez (1979), three options for dealing with this situation have been applied in varying combinations in the different countries: an increase in the number and relative proportion of wage-earners in the active population within the agricultural sector; the physical expansion of subsistence farming (although at times this has occurred only in terms of the number of people and production units); and increased migration to the cities. At the same time, however, the capitalist type of agrarian economy has clearly been becoming the predominant form. All the rest, in one way or another, have come to be dependent upon it; in the case of small landholdings, this has been due to the occasional hiring out of manpower; in the case of independent peasant farmers, it has been because they have had to sell a portion of their surplus output on a market in which the capitalist form of agrarian economy had a decisive impact; and in the case of large landholdings, it has stemmed from the need to restructure internal production relations in order to remain competitive in the market. In this regard, Miró and Rodríguez (1982) noted that no progressive homogenization processes have been observed to be at work in the region's agricultural sector, and that the impact of the capitalist economy on this sector is manifested in some geographic areas and spheres but not in others. Gomes and Pérez (1979) believe that the peasant economy is also linked to the modern agricultural sector through marketing firms and agribusiness, which have developed in conjunction with the capabilities for expanding commercial agricultural production. These companies tend to manage the market on a monopsonistic basis, which gives them an additional means of securing the surplus produced by the peasant sector; the peasant farmers, for their part, are the ones who usually have to absorb the effects of price fluctuations and gluts on the market.

López Cordovez (1982) lists a series of traits characterizing the modern agribusiness sector: greater homogeneity as a production segment, firms whose economic size ranges from medium-scale to large, considerable control over production resources, a substantial amount of capital and a certain investment mix, the adoption of relatively complex technological systems, some degree of specialization in the chosen product lines, sophisticated technical and administrative organizational schemes, the establishment of certain types of labour relations,

interrelationships with other spheres (e.g., finance, manufacturing, commerce and the media), and ties to centres of power and decision-making. In addition, as indicated by Gomes and Pérez (1979), modern enterprises are the ones that most often benefit from government investment in infrastructure and from many economic incentives and support services, as well as access to credit, profitable prices, relatively protected markets and technical assistance. As a result of all this, new technologies tend to be concentrated in firms of this type and modern business conglomerates tend to become consolidated. Another feature of these groups is their political ability to secure the support of the State apparatus.

Transnational corporations have also played a role in the modernization process, not only in traditional agrarian activities but also in the creation of agribusinesses. Although agribusiness has been around for some time in the region and the food sector is actually one of the most important components of regional industry, it mirrors the pattern exhibited by the industrial production structure. It is also true that within the agricultural sector, the branches that produce staples expand more slowly than do those making products designed for middle- and upper-income strata.

López Cordovez (1982) contends that agribusiness depends primarily upon agricultural entrepreneurs for its expansion, since they can provide linkages between its production activities and commercial activities. Agricultural enterprises therefore gear their products to the tastes of middle- and upper-income urban consumers who can afford to buy their processed products. Agribusiness, according to the above author, thus bypasses peasant agriculture and poor rural and urban consumers. Transnational corporations have not, however, confined their activities to the development of agribusiness; there has also been heavy foreign investment in agricultural machinery, agrochemicals (fertilizers, insecticides, fungicides, herbicides) and veterinary products.

An increasingly widespread shift towards wages as the preferred form of remuneration for agricultural workers has gone hand in hand with this transformation of the agrarian sector. The changeover to wage-based remuneration has not, however, always ushered in more permanent employment situations. Temporary work has become a quite common hiring basis, and is routinely used in Argentina and Chile for the fruit harvest and packing and in Central America for the coffee harvest, but it is spreading to

other activities as well. In Brazil, an estimated 40% of the agricultural workforce is hired on a temporary basis. According to Kozminski (1984), this practice is associated with the introduction of labour-saving technology in some –but not other– phases of the production cycle for each crop and with the oversupply of labour. In some cases, employers even go to the cities and to the outlying areas of major metropolises to recruit temporary workers for seasonal jobs. For Miró and Rodríguez (1982), the hiring of temporary workers to take the place of permanent employees is associated with the surplus supply of labour; however, when there is no such surplus or alternatives are available (such as migration to areas along the agricultural frontier), relations similar to those seen in sharecropping systems, or even openly semi-servile relations, tend to be recreated. The hiring of temporary workers takes place even in areas where agribusinesses are operating when labour shortages arise.

Paradoxically, an increase in family farms has accompanied the development of the agribusiness economy. This expansion of the peasant-farmer, or *campesino*, sector has been a quite widespread phenomenon in the Andean countries (Bolivia, Chile, Ecuador and Peru), but it is also beginning to be a factor in, for example, Central America as well. Agrarian experts characterize the fundamental motivation for peasant agriculture's economic activity as being to ensure the household's income level, reproduce its workforce and permit the replacement of farming tools and equipment. The organization of its production tasks is family-based, and the main aim is the reproduction of the family unit in either its present or an expanded form. This sector should not, however, be thought of simply as the continuation of a traditional activity.

Indeed, during the crisis of the early 1980s, peasant agriculture's response capacity was sometimes better than that of agribusiness, and it helped to make the decrease in the output of commodities less sharp than had been feared. There have even been some cases where groups of small-scale landholders have managed to obtain better terms of trade for food products on the domestic market while receiving increased State assistance for peasant agriculture. Nevertheless, since the primary goal of the peasant-farmer economy continues to be to ensure the survival of the family group, with the emergence of these new conditions peasants have begun to spend part of

their time working for wages on production units not run by their own family. The income earned in this way has become a basic component of peasant-household subsistence and of the peasant economy itself.

### 3. The services sector

The development of the services sector and its implications are a subject of debate in Latin America today. As compared to the experiences of the advanced countries, this sector's growth does not appear to bear any relation to the level of development of the sectors engaged in direct production activities. In 1980 the share of total Latin American economic activity accounted for by services was similar to what it had been in the central capitalist countries in 1960, and in countries such as Argentina, Chile, Colombia, Uruguay and Venezuela, the figure was the same as or higher than the 1980 figures in the economies to which they were being compared (Pinto, 1984). This fact notwithstanding, other authors have indicated that the way we look at the services sector has changed. They maintain that development was traditionally regarded as a process that took place in stages and as a gradual transition from agriculture to industrialization and from there to a post-industrial stage that was sometimes known as a "service-based" society.

Prieto (1986) notes that some later studies have attributed special importance to the links that appear to exist between certain service activities and the rest of the economic and social fabric. He feels that the externalities generated by these links are of such a magnitude that the efficient, inexpensive provision of certain services will not only become one of the determinants of the pace of development, but will also play a crucial role in shaping the development styles and patterns being sought by the countries of the region. This appears to apply to the current phase of the international economy's development, although we need to determine which services may be playing such a role and which are not and are therefore part of the phenomenon that has come to be known as "spurious tertiarization". This author also discusses the size of the services sector in Latin America and its economic, social and technological significance; on average, this sector contributes around 60% of the total value added by the region and employs at least 46% of its labour force; the latter figure may be even higher, in view of the concentration of labour and the importance of service

activities in the vast informal sector of the economies of the region. Without attempting to downplay the significance of the services sector, it should be noted that this last statement introduces a note of caution with regard to the role it plays. While recognizing the modernization of many elements in the sector, Pinto (1984) draws attention to the hypertrophy of Latin America's major cities and associates it with a spurious form of tertiarization, especially as regards unskilled services and various forms of underemployment or informal work.

The above is highly relevant to our exploration of Latin America's social structure and stratification, and especially to our understanding of how they are changing. We might therefore consider a few specific cases by way of example. Kaztman (1984) says that studies conducted in five countries (Brazil, Costa Rica, Guatemala, Peru and Venezuela) in the early 1980s indicate that production-related services (banks, credit agencies, financial institutions, insurance and real estate agencies, warehousing services and general business services) had the fastest rate of growth but represented only 7% of this sector. The second-fastest growth rate was that of social and community services, including government activities, the armed forces, health, education, culture, social welfare, communications, urban sanitation and other services that are primarily provided through the State apparatus. Distribution services (transport and commerce) were in third place (except in Brazil) but employed the lion's share of the workforce in the tertiary sector. Personal services –the largest component of which was domestic service– were in fourth place. Actually, this highly heterogeneous sector has indeed undergone some technical modernization, but these processes have for the most part been concentrated in informatics and financial services.

However, since modern services are bringing about changes in the characteristics of middle-income strata, it is worthwhile to consider this situation further. According to Prieto (1986), the transnationalization of services has been a logical extension of the transnationalization of goods. It has taken place within large conglomerates in the fields of banking and insurance, advertising, auditing and in many other services that provide essential support for the internationalization of the economy of the central countries. Both transnational corporations and other types of firms in the transport sector have undergone a modernization process with the introduction of containers and their associated technology and the

integration of different modes of transport into large-scale operations. Even in the production of goods itself, the services component has expanded, particularly in the area of informatics; this is especially the case for high-technology products in which international trade is burgeoning. Technology is an influential factor in the internationalization and thorough-going transformation of certain services –including some professional services which previously were provided almost exclusively by the domestic market (e.g., architectural services and management consulting)– in which computerized design or management techniques are being applied. It should be noted here that these modernization processes may also lead to increased concentration.

In addition to the modernization of services through the introduction of new technologies, however, changes are also taking place in some services' traditional forms of organization, and this has implications for the economic and social power structure. A particularly significant phenomenon in this connection is the merger of banks with non-banking financial institutions to form "multi-banks" which offer passbook savings accounts at the same time as they engage in open-market operations, administer investment and mutual funds, engage in mortgage banking, facilitate individual or corporate operations in the construction industry, etc. Moreover, investment or merchant banks have often moved over into commercial banking, and the banking industry as a whole has expanded into other sectors to form large, diversified holding companies. Foreign groups have played a pivotal role in this process.

As we have seen, the services sector is extremely heterogeneous and the social strata that make it up are highly diverse as well. A connection is often made between the tertiary sector and middle-income strata, and although this may not be entirely appropriate, since these strata are also very much a part of other sectors of the economy, the fact remains that in Latin America their growth and their social and political influence have been closely associated with the characteristics of the tertiary sector.

According to Wolfe (1990), as a result of the crisis of the 1980s –although other earlier, and not exclusively economic, factors may also have had an influence– middle-income wage-earners found themselves in insecure positions and saw their incomes decline. This may have widened the gap between reality and the aspirations of these groups (especially as they related to modern consumption patterns and

inter-generational upward mobility), which had become deeply entrenched during the years of economic expansion. Among the middle-income strata, the groups that had grown the fastest had been those positioned within the technocracy, professional fields and government bureaucracy, which were the main sources of employment for university graduates. Employment in these areas, in numerical terms, was maintained or even grew in some cases despite the crisis and policies aimed at trimming down the bureaucracy, but only at the cost of wage reductions and a deterioration in working conditions.

Rama and Faletto (1986) draw attention to the fact that the intellectual frames of reference for these groups have changed radically, becoming similar to those of their counterparts in the developed world, with the adoption of attitudes that emphasize efficiency, functional specialization, rational organization and new concepts of the State. Some dependent or wage-earning middle-income groups formed as a result of the expansion of the State's administration functions, and others did so thanks to the development of commercial services designed to meet a rising level of consumer demand in urban areas; still others owe their existence to the increase in social and community services, particularly education and health. Independent, non-manual middle-income strata, on the other hand, saw their influence decline throughout the region, were crowded out by the growth of the State and of large economic organizations and, in many cases, even declined in status relative to other groups, such as, for example, skilled manual workers. The technocracy and bureaucracy—or, more accurately, the members thereof—played a key role, however, as they administered the functions, on an *ad hoc* basis, of public resources in relation to capital accumulation and the reproduction of the labour force, and went on to articulate and mediate the relations between classes or between private interests and those resources. For all intents and purposes, their role as mediators transformed them into policy-making agents.

#### 4. The Informal sector

Many authors have drawn attention to the persistence of concentrative and exclusionary elements in the prevailing development style, with the most obvious manifestation of these elements being the size of the "informal" labour force. The Regional Employment Programme for Latin America and the Caribbean

(PREALC, 1988a) has found that the growth of the economically active population (EAP) did not slow down during the crisis (i.e., between 1980 and 1983). Initially, the adjustment chiefly took the form of a rapid increase in open unemployment and, later, in a sharp increase in urban informal employment. The 1984-1985 biennium saw the beginnings of a partial recovery: total unemployment fell by 8%, but much of this improvement was due to an increase in informal employment. Employment rose by around 2.6% annually in the formal urban sector but by nearly 7% in the informal sector. Between 1985 and 1987 the recovery strengthened, but informal employment continued to rise steeply and, in fact, served as the vehicle for the labour market's adjustment. It should be remembered that informal employment exists in all economic sectors; for example, in the manufacturing sector informal employment levels are fairly high—close to the average for the other sectors of the economy. Thus, we not only need to ascertain which individuals make up the informal labour force; we also need to bear in mind that many are linked to "informal enterprises".

Castillo and Cortellese (1988), quoting Víctor Tokman, describe "informal enterprises" as rudimentary organizations lacking a clear-cut division both of labour and of the ownership of the means of production, having very little capital invested and low skill requirements. "Informal enterprises" have difficulty gaining access to competitive markets and to the demand base of concentrated markets, and their ability to compete is determined by average income as an adjustment variable. In the presence of market constraints, the greater the amount of surplus labour, the lower the incomes of the individuals working in informal activities. During the recession, notes Wolfe (1990), the drop in the output of modern consumer-goods industries, in import capacity and in consumer purchasing power left some room open for small, unregulated industries, but large companies probably moved in to take up this slack by using the informal sector for piecework and the marketing of products by street vendors.

According to PREALC (1987), although informal economic activity is largely the result of the search for enough income for survival, the Governments have adjusted by passive means to this state of affairs through their tolerance for and gradual legitimization of a *de facto* situation. This is the case with respect to substandard housing, the unregulated operation

of transportation services and the growth of unauthorized commercial activity. Even as a response to the crisis, in many cases efforts were made to increase the flexibility of the labour market by modifying the labour laws or cutting back on inspections and adopting a more tolerant attitude to the evasion of the regulations in force. As was to be expected, all of this made it more difficult for the organized sectors' trade unions to pursue an active policy of collective bargaining. It is also important to note that a number of authors have likened the relationship be-

tween modern and informal activities to a trade balance. The informal segment of the economy purchases its capital goods, many of its production inputs and most of its households' consumer goods from the modern segment of the economy and, in its turn, sells a sufficient amount of a variety of goods and services to wage-earners in the modern sector to keep this trade balance in approximate equilibrium. Hence, the division of society into those who are included and those who are excluded does not signify the absence of relations between the two.

## II

### Social stratification and community of interests

The above-mentioned heterogeneity raises a social and political question as to the possibilities for collective action, i.e., the opportunities for certain sectors or groups to determine the course of the social and political process or at least to influence it. In this regard, we need to examine certain conditions for collective action that arise out of the capacity to achieve and organize a community of interests, whether as a means of corporate defence or as a way of presenting those interests as an agenda for society.

#### 1. Heterogeneity and the possibility of achieving a community of interests at the corporate level

In Latin America the virtually absolute ascendancy of neoliberal thought could lead to the facile conclusion that entrepreneurs have not only achieved a community of interests as a sector, but have also managed to shape those interests into an agenda capable of being embraced by the whole of society. The term hegemony, as used by Gramsci, could thus be applied to entrepreneurs in their capacity as a group of leaders. However, at this level of abstraction we are not in a position to comprehend the actions taken by entrepreneurs which, under certain circumstances, would enable them to exercise that hegemony.

It should be noted that the heterogeneity of entrepreneurs as a group has increased beyond the point that was traditionally used to differentiate them according to size and sector of economic activity. This reduces their chances of achieving a community of

interests. Inter-company differences in technological sophistication are important, but the nature and level of their links with other firms are more so, especially on a transnational scale.

Very little information about the upper reaches of the entrepreneurial sector is to be had, since information about the actual links existing at this level, the extent to which given entrepreneurs control different firms and the make-up of business conglomerates is generally viewed as confidential. Existing studies do, however, tend to stress the increasingly important role played by large transnational corporations in the formation of the major holding companies and the financial segment's ascendancy over the rest.

Except in some very generic areas, such as tax policy, it is usually no easy task to achieve an overall uniformity of interests. Disputes often arise between different actors which then put pressure on the State to enact measures favourable to them. The main parties to such disputes are usually national holding companies with links to transnational corporations, on one side, and firms oriented towards the domestic market, on the other.

Transnational holding companies tend to regulate their own conduct, which is why they are strong advocates of the idea that the economy can manage without State intervention and that it should be as open to external trade as possible. For their part, firms that produce for the domestic market tend to develop forms of corporate organization that will

enable them to defend their interests, which are almost always linked to specific kinds of products, and tend to call for State regulation, especially, *inter alia*, in the form of tariff protection, support prices, soft loans and technical assistance.

These leading actors of the entrepreneurial sector are not new in Latin America; on the contrary, they have almost always set the tone for the dominant sectors and have often had a turn at being in a position of pre-eminence themselves. What appears to be happening now is that many of the advantages acquired by companies involved in producing for the domestic market during the import-substitution stage are slipping away, and the export sector is once again becoming more influential. The transnational holding companies now operating in the region often defy a clear-cut differentiation between domestic and external markets, however. The segmented transnationalization of the domestic market for goods and services, along with the growing transnationalization of the labour market, even makes it extremely difficult to draw the above distinctions.

Large-scale, modern entrepreneurs are often quite cosmopolitan, with links to the international economy and a broad array of production sectors in the country and abroad. Their participation in vertically- and horizontally-integrated holding companies and in a wide variety of areas of economic activity make them very well equipped to regulate themselves and reduce or eliminate the need for them to champion their interests before the government. What is more, if it does become necessary to do so, they can command the attention of the authorities directly, who will be wary of the consequences if these companies were to mobilize their enormous economic power. In any event, the existence of this situation was brought out quite clearly during the external debt crisis.

Apart from these groups, the creation of a community of interests within the entrepreneurial sector—always a difficult undertaking due to the differing and even conflicting needs of the sector's various activities—is usually carried out through trade organizations having a long history in the region. These organizations usually act as pressure groups whose effectiveness tends to bear a direct relation to how specific the group they represent is. Today, however, entrepreneurial trade associations appear to be steadily losing power. This situation fits in with the increased entrepreneurial heterogeneity to which we referred earlier and is reinforced by the large

transnational corporations' tendency to integrate other entrepreneurial groups into subordinate positions while linking these groups' interests with their own, thus disrupting the solidarity that could form among entrepreneurs of a similar status or nature.

Despite all this, however, in various countries of the region the perception of a serious threat (which may have been real or imagined, but which was certainly seen as being real) to the very foundations of the entrepreneurial class sparked a strong reaction and thus strengthened its trade organizations. Later, the wave of authoritarian regimes that swept over the Southern Cone and other countries of the region found a staunch supporter for its establishment and preservation in these trade organizations, whose strength and capabilities for action were thus further augmented. As a result, these organizations have continued to be quite strong even during the period of democratic consolidation. But their strength is more political than economic, and tends to wane as the modernization process facilitates the formation and predominance of large national holding companies with ties to transnational capital.

## 2. The formation of a community of interests in middle-class strata

Apart from the theoretical and empirical difficulty of defining the middle class, considerable changes have taken place in terms of the representation, organization and action of certain groups with which it has been identified.

In the past, the most visible representatives of the middle class were a large contingent of employees in both public and private services that provided training and reproduced prevailing living conditions, a stratum of professionals and technicians, and a large petty bourgeoisie that had ties to the various economic activities and was especially numerous in the fields of commerce and transport. Its direct links to the State or its reliance on the demand generated by working- and middle-class strata contributed to its articulation in development agendas directed towards the incorporation into society of sectors that had been bypassed by the system.

Achieving a community of interests was a strong possibility in the public sector, where the capability existed to bring pressure at both the trade-organization and political levels. At a professional and technical level, trade associations' corporate defence efforts were quite successful. The petty bourgeoisie, on the

other hand, had great difficulty in achieving a community of interests, except in occasional cases where it was able to mobilize itself with the help of organizations which, although not very cohesive, managed to become a referent for collective action under very specific circumstances.

Today, the situation has changed a great deal, although the extent of that change varies markedly from one country to another (ECLAC, 1991).

One such change has been a sharp reduction in government employment owing to the rapid privatization of State production and service enterprises. Even in those instances where State employment has not been subject to direct cutbacks, its relative magnitude has declined in particularly important activities, such as education and health, which find themselves in an uneven contest with private firms that discourage their workers' efforts to assert their demands.

The public-sector crisis, which affected the individual Latin American countries in very different ways, occasioned the loss of structural positions that had afforded a relative capacity for forming a community of interests and establishing strong organizations. The emergence of private enterprise in the social services has not only led to the diversification of the counterpart services but has also helped to heighten the sector's heterogeneity. This increase in heterogeneity makes it more difficult to achieve a community of interests, since it has given rise not only to huge differentials in remuneration levels, but also to different forms of linkages with corporate bodies and labour.

Meanwhile, the loss of the "liberal" character of the activities of professionals and technicians has been accelerating as these people move, under widely differing conditions, into companies characterized by large investments in equipment and technology. The situation in the health field provides a particularly good illustration of this state of affairs, but similar situations are to be found in all areas of endeavour. In addition, new technicians and professionals are coming up who are joining companies that are very directly involved in production, such as modern advertising, communications and informatics. Their lack of a trade-union tradition and their heavy reliance on investment in technology leaves them unprepared for attempts to broaden the base of their interests at any level whatsoever. Moreover, since these are new types of activities, individual expectations of social mobility are very high, which militates against an orientation towards collective action.

Finally, the petty bourgeoisie, which always has difficulty in arriving at a community of interests, is also increasing in heterogeneity. This is caused not only by technological progress and integration into an economic model dominated by a tendency towards transnationalization, but also by the emergence of a new segment of small-scale entrepreneurs who have been crowded out of public-sector employment and have undertaken activities on their own account in commerce, transport, and even manufacturing and agriculture. Medium- and small-scale entrepreneurs' dependence on large-scale enterprise is also spreading via subcontracting practices in the services sector and by way of product processing, distribution and marketing networks (agriculture and fisheries) or component integration (manufacturing) in the production sector. This increased heterogeneity and dependency makes it even more difficult to establish a community of interests and lowers the profile of small and medium-scale entrepreneurs in the entrepreneurial sector's trade organizations.

If, in addition to the changes that have occurred in each segment of the middle class, we now look at how these various segments have changed in proportion to one another, we see an increase in the presence of those segments that are most receptive to identification with the entrepreneurial sector and to a corresponding ideology, which reinforces individualism and contributes to the fragmentation of these strata. At the same time, these strata find it more difficult to adopt positions that will bring them closer to the working class, as they had done in the past during times of greater social integration. And finally, the segmentation of the markets for goods and services and their internationalization discourage the middle classes from defending redistributive policies or championing the integration of the working class.

### 3. Community of interests in the working class

Over the years the region has devoted special attention to the working class owing to the importance—both attributed and real—of the role it has played in shaping highly influential social and political forces ever since Latin America's industrialization process began. The European development pattern, which is always present, either implicitly or explicitly, in analyses of this subject in the region, has guided many of the comparative studies done in this area (including, among others, that of Przeworski, 1983).

The working class's ability to achieve a community of interests was virtually taken for granted, while socialist thought clearly conferred upon it the revolutionary option of moving beyond that state and casting itself as the foundations for a reorganization of society. What seemed difficult for others to accomplish was presented as something that simply came naturally to workers. Although their mission in history might be called into question, trade-union organizations became an established fact as the industrialization process proceeded, and their political role also seemed clear in relation to phenomena such as populism or the configuration of what has sometimes been called the "committed State".

Studies on this sector conducted by ECLAC have told of significant changes that have a very direct impact on this sector's ability to form a community of interests and to act as a collective body (ECLAC, 1989). According to a quantitative estimate relating quite closely to the issue posed by shifts towards or away from the use of wages as the main basis for workers' remunerations, movement in the direction of wage-based remuneration, when viewed as a natural phenomenon of capitalist development, is neither linear nor constant or irreversible; generally speaking, there was movement (although it was not very rapid) in this direction during the period 1950-1980, but the crisis of the 1980s appears to have reversed this process.

In the agricultural sector, also according to these studies, a rapid shift towards wage-based remunerations took place as a result of the build-up of capital assets that accompanied the development of modern agribusinesses oriented towards exports and the domestic market. Contrary to what would be expected, however, this transition towards wage labour has not led to a homogenization of agricultural workers, which obviously hinders attempts to arrive at a community of interests. Moreover, the conditions associated with the type of enterprise in question are not the only relevant consideration in connection with a shift towards wage-based remuneration schemes in the agricultural sector; the seasonality of the production activity is also a factor and has given rise to a large segment of temporary workers –including many urban workers and women– having highly specific traits. A similar situation, albeit with some differences owing to the type of activity involved, is found in the fisheries sector.

In the manufacturing sector, the above studies indicate that workers are in very different positions

depending on whether they are employed in large-scale modern industries producing capital or intermediate goods, consumer durables or non-durables industries, medium- and small-scale manufacturing enterprises, workshops or construction. When differences in technological capabilities are added to this picture, it becomes clear that the sector exhibits a marked degree of heterogeneity which is manifested in differing and even opposing interests.

In the mining sector there have also been sweeping changes which have affected the capacity for action of sectors that have traditionally been very active in the trade unions and politics. Through a process which has long been at work but which has intensified in recent years, the introduction of modern mining technology has been edging out the labour-intensive forms of production which used to assemble vast numbers of unskilled workers in mining camps where they lived in closely-knit communities. As a result, the number of workers employed in mining has fallen sharply, while the skill levels required have risen. Although some traditional mining companies still remain, they are clearly in decline and their only chance of survival lies in re-tooling, which would translate into mass lay-offs of workers; the privatization of mining concerns would only accelerate this process. In countries with a long history of mining activities such as Bolivia, Chile and Peru, the situation has sparked a defensive mobilization on the part of the workers concerned, who have not, however, been able to halt the lay-offs, although in some cases they have managed to delay privatization. In more colourful terms, we might say that the image of coal or copper miners is being eclipsed by that of oil drillers, whose more limited numbers, high skill levels and large incomes generate other types of interests that differ from those of the great mass of workers in the country.

Finally, the above-mentioned studies indicate that the number of workers employed in the services sector has risen steeply, thereby giving rise to what has been dubbed the "tertiarization of the working class". This is in keeping with worldwide trends towards the use of modern technology in manufacturing and the growth of the tertiary sector. The increase in such workers has been especially notable in the fields of transport, communications, repair work, and personal non-domestic services (ECLAC, 1989). The upshot has been a "tertiarized" working class representing a third or more of the economically active population in many countries of the region. The

characteristics of this segment differ from those of the industrial working class which served as the basis for all the analyses of conditions and forms of action in terms of the struggle between classes. These differences arise not only because tertiarized workers are not directly involved in material production activities, but also because their working conditions are not conducive to collective identity and action. They usually work alone or in small firms, they generally lack job stability or a permanent contract, and the companies in this field, including the large firms, tend to subcontract work out to small- and medium-scale entrepreneurs, thereby making such workers' employment situations even more unstable. If we look at the situation of each segment of the working class, it becomes clear that even at this level it is difficult to achieve a community of interests. Their heterogeneity not only reduces the number of workers in equivalent situations; it also worsens the conditions in each case under which such a community might be formed.

If we now look at the overall picture with regard to manual workers, we see that those segments which usually assumed leadership positions in the presentation of workers' demands have declined in strength. The decrease observed among workers employed in manufacturing appears to be the most significant development in this connection when considered in conjunction with the earlier reduction in the combative ranks of miners.

The re-articulation of workers as a sector does not promise to be an easy task, given the loss of their identity as "the working class" as a result of the labour shifts which have added to the influence of the tertiary sector at the expense of the production sector. At the same time, the greater degree of heterogeneity among business enterprises translates into sharp differences among workers that hinder the formation of a community of interests. What is more, even when some measure of communality is achieved, it is usually in reference to specific firms and activities, and this generates a tendency towards isolation and corporate defence rather than a search for broader areas of agreement.

Another relevant phenomenon is the spread of unstable labour relations in this sector. In some cases the differences between a greater or lesser reliance on wages as the primary basis of remuneration become meaningless as new types of relationships between workers and firms, new ways of organizing the work to be done, new systems of remuneration and other

new elements are developed which move us away from traditional classifications. We are not referring here to the forms of job instability that have long characterized domestic service or temporary agricultural work, but rather to novel types of relationships that represent departures from formal work contracts for stable, regularly-paid jobs. Today, contracts tend to be task-based, offering no guarantee of stability or social reproduction; these contracts disconnect the firm from the worker in every way except the purchase of the labour incorporated in the product in question. This results in very little worker solidarity, since workers compete with one another and often do not even perform their jobs in the same physical location. Furthermore, the workday has no definite limits, since the firm is buying the work performed, not the worker's time, and even in the event of legal limitations in this regard, work shifts can be prolonged through the mechanism of overtime or, more simply, by contracting other shifts in other companies.

In sum, these changes—stemming from trends towards wage-based systems of remuneration in the agricultural sector, manpower reductions and changed conditions in the mining sector, the shrinkage of the working class in the manufacturing sector, worker "tertiarization", heightened job instability, and the growing heterogeneity of manual workers—reduce the chances of shaping a community of interests among the various groups of workers. At the same time, a decline is to be observed in the forcefulness with which workers present their demands—generally to the State—for measures to ensure the reproduction of the labour force through policies on health, education, housing and social security. Thus, the crisis of Latin America's infant welfare State and the privatization of those services makes the possibility of establishing community of workers' interests at that level more remote.

#### 4. Marginality

For the purposes of our analysis of the possibilities of broadening the base for a community of interests and of collective organization and action, the concept of marginality appears to be a more suitable choice than those of poverty or the informal sector, although these latter terms may be the concepts of choice in other contexts.

The prospects of achieving a community of interests in the various segments of the population and of representing those interests are not determined by

income levels but rather by those segments' different structural positions. The fact that a given structural position engenders poverty does not signify that the two terms mean the same thing. On the contrary, there are many poor people in the working class, but their poverty does not bar them from membership in that class.

The distinction with respect to the informal sector is perhaps more difficult to define, since marginal workers usually enter into informal work situations. Nevertheless, the most concrete definition of the concept of formal economic activity refers to compliance with labour laws and is therefore not applicable to a vast segment of marginal workers who, because they work as direct producers of goods and services or because of other circumstances, do not enter into the types of labour relations that can be formalized. The same can be said of the legal formality of their independent economic activities.

The difficulties which one encounters in trying to define informal economic activity in non-legal terms do not make such an option advisable either, although, as we have seen, it can be very useful in determining the structural economic conditions of stratification. Tokman's (1979) observations remain valid in this regard, although it would be very hard to envision a community of interests in the informal sector.

Despite its theoretical obscurity, the concept of marginality has a connotation of exclusion which is of particular importance in a region heavily influenced by an economic model that leads to an increasing degree of systemic integration and, at the same time, to social exclusion. The latter is what constitutes social marginalization, whereby some portions of a population are structurally excluded both from prevailing production relations and from a share in the social product.

Of course, marginality is a relative concept, since certain types of positions within the working class and even among non-manual workers with low skill levels entail a significant degree of marginality. Here, however, the concept refers chiefly to the type of link with production activities maintained by the sectors that are categorized as marginal (i.e., persons who have no regular arrangement for the sale of labour and are not part of a petty bourgeoisie which sells independently-produced goods and services).

It should be borne in mind that, according to the findings of empirical studies, informal activity is not always or inevitably synonymous with underemploy-

ment, low productivity or extreme poverty (ECLAC, 1989). This has led some researchers to use quantitative definitions of living standards in an attempt to conceptualize the phenomenon of poverty, which has been the subject of a number of recent analyses whose findings are quite disquieting.

The conceptualization of informal activity or of poverty is not aimed at determining whether or not conditions are conducive to the formation of a community of interests or to collective organization or action. Instead, the objective is to identify situations in which levels and modalities of economic development can be measured, usually as a way of providing inputs for the design of policies to deal with certain problem situations. This is particularly clear in the case of measurements of poverty and proposed courses of governmental action to address the most serious situations.

In contrast, the question of marginality has had a strong political connotation from the very start. In the 1950s, there was concern about the possibility of marginal sectors becoming mobilized, either spontaneously or otherwise. Later, in the tumultuous 1970s, attention turned to these sectors' revolutionary potential.

Originally, however, the concept of marginality contained a spatial element, in that the people classified as marginal were those who lived in makeshift housing located on the "margin" of the cities, in "shantytowns", "squatter settlements", "outlying slums", etc. Not until later was marginality thought of as a structural position linked primarily to occupational status; at the same time, however, occupational marginality was implicitly assimilated into spatial marginality, even though empirical studies conducted in the 1960s showed that the composition of low-income groups is much more varied and is not necessarily a focal point of structural marginality.<sup>1</sup> In fact, studies continue to be conducted in these squatter settlements, while marginality has not been a major subject of analysis.

These complications make it difficult to present a clear picture of the evolution of structural marginality because of the lack of accurate information on the subject. If we refer to the related categories of poverty and informal activity, however, we can at least deduce that a large segment of the population is in a situation of structural marginality and that the size of this segment does not appear to have decreased in the 1970s or 1980s.

<sup>1</sup> One such study was carried out in Chile (CIDU, 1972).

Although this is by no means an exhaustive list, some of the groups falling into this category are itinerant vendors or peddlers, a large percentage of domestic servants, *campesinos* working within a subsistence economy, self-employed workers providing personal services, the chronically unemployed and the *lumpen* in general.

Once again we have here a highly heterogeneous assortment of positions, but in this case the heterogeneity is so great that, except at very abstract levels, the formation of a community of interests is virtually impossible.

Marginal sectors are generally thought of as presenting demands for urban services, especially housing, and as taking part in movements in support of those demands. However, the collective organizations and action mounted for this purpose primarily arise out of the spatial marginality found in squatter settlements, which, whether as a result of natural population growth or immigration, reach such high population densities that they become unbearable. Thus, we cannot simply state that demands for urban services are an interest common to the whole of the structurally marginal population, even though the majority of people mobilizing in an attempt to secure such services are members of that population segment.

Demands for urban services, which have been a significant factor in Latin America, do not appear to bear any direct relation to given positions within the production structure, except that, of course, unsatisfied needs for the most basic urban services are found in the most underprivileged sectors of the population. What is clear, however, is that, in the case of marginal groups, these demands are directed solely towards the State, whereas manual and non-manual workers can turn to the entrepreneurial sector to incorporate this particular cost of the labour force's reproduction.

This points up an important and quite generic trait of marginal groups: whether or not they have common interests, they do indeed have a common supplier: the State. It is to the State that they make their demands, which take on a measure of homogeneity when they concern basic needs at a subsistence level, rather than as an independent expression of structural positions.

This is the origin of the concept of urban plebeians (although in Latin America they are not only urban), which can be used to denote marginality. Urban plebeians do not have interests that can be embraced by an entire sector and, consequently,

cannot organize themselves. Instead, they remain a group of isolated individuals who lack any social connection with one another no matter how long they may continue to be in a similar situation. The social position of the masses prevents the formation of a collective identity, and each individual strives to establish a direct relationship, or a relationship mediated by a patron or benefactor, with sources of power. These sources are what can provide that individual with a share of the social product which will meet those of his basic needs that his economic activity does not allow him to satisfy.

Given the structural position of the urban plebeian, which impedes the attainment of any community of interests based on that position as well as any form of social organization, action by members of this group tends to have political implications although politics as such may not interest them. Only charismatic political leaders or disruptive social movements can elicit their involvement by offering formulas for community integration or promises of greater responsiveness on the part of the authorities to their needs.

The relationship between this sector and such phenomena as populism and authoritarianism would be a worthy subject for in-depth analysis, as is demonstrated by several pioneering studies in this area (Medina Echavarría, 1964; Germani, 1960; Weffort, 1970).

##### 5. Social organization and its difficulties

As we have been saying, the increasing degree of structural heterogeneity is a direct cause of problems in respect of the formation of a community of interests, and such problems clearly hinder attempts at social organization on that basis. Obviously, this does not mean that all these organizations will disappear, but it does change them in ways that affect their ability to take action. In addition, sectors appear that are left out of these organizations.

The main interest-group organizations continue to be those formed by entrepreneurs or employers, on the one hand, and by workers, on the other. Both have undergone considerable changes.

Among entrepreneurs and employers, a loss of strength has been noted on the part of those entrepreneurial associations that were involved in industrial development during the stage of inward-oriented growth, when their efforts were primarily directed towards persuading the State to implement

protectionist policies. These organizations include the General Economic Confederation in Argentina, the Manufacturers' Association in Chile, and the Chamber of Industry in Uruguay. The predominance of large conglomerates or holding companies with ties to transnational corporations, which either regulate their own operations or put pressure directly on the Government, also siphons off power from entrepreneurial associations.

Nevertheless, some studies (PREALC, 1988b) indicate that entrepreneurial associations' loss of economic influence is often offset in the short term by their political influence. This is what happened when authoritarian regimes rushed to the defence of private enterprise in the tumultuous 1970s, and it also happens when efforts to achieve macroeconomic equilibrium lead to forms of social consensus-building in which trade associations are called upon to act as representatives of capital in dealings with unionized labour.

Independently of these circumstantial situations, entrepreneurial organizations retain a measure of influence when they are associated with specialized production activities. In such instances, however, they tend to adopt a defensive stance in response to the prejudicial effects of an economic policy which acknowledges the hegemony of the transnationalized segment of this sector.

Among workers, the changes appear to be more visible and more drastic (Wolfe, 1990). Modifications in the composition of the labour force have greatly weakened trade union organizations. Some of the main contributing factors in this regard have been the shrinkage of the industrial working class, the decrease in government employment, the tertiarization of workers, changes in the way work is organized, increased job instability, the practice of basing remuneration on output rather than on the amount of time worked and, above all, the labour force's increasing heterogeneity and its adverse effects in terms of the formation of a community of interests.

Generally speaking, second- and third-tier trade union organizations are the ones that have lost the most strength. It is becoming increasingly difficult—and in some cases it is even against the law—to negotiate working conditions by branch of activity or on a nationwide basis. Union activity is for the most part being maintained and growing stronger only within large companies, where the trade unions are developing a more sophisticated approach to collective bargaining and are trying to put up resistance to the trend towards individual contracts.

During the crisis years of the 1980s, national trade unions successfully led some movements to defend workers against recessionary adjustment policies. Even when they did meet with a measure of success, however, the persistence and increasing severity of the crisis sapped their strength as labour leaders and, in most cases, left them powerless to resist policies that directly affected their *raison d'être*, such as those calling for wage cuts and massive lay-offs.

Later, when social consensus-building became necessary in order to ensure the effectiveness of measures designed to achieve macroeconomic equilibrium, national trade unions became the object of a political reassessment. Their status as labour representatives soon deteriorated, however, because their role was to curb wage demands, and the immediate, direct benefits of that sacrifice were not apparent to the sectors they were supposedly representing.

Moreover, except in these specific situations, organized labour at the national level has been weakening as the balance between union and non-union workers tips steadily towards the latter, especially as women who generally lack a tradition of union activity, self-employed persons and informal workers join the labour force.

The present situation might be described as one of union organization at the company level, with that organization having a partial coverage and being of varying strength depending on the categories of workers involved. The type of company and the nature of the labour relations in question are decisive factors in determining the workers' chances of organizing themselves and the amount of power they are able to wield in defence of their interests.

In the middle-income strata, the trade unions have been weakened by the reduction of public-sector employment and by an increase in the proportion of self-employed workers among their ranks.

Given the characteristics of marginal sectors, trade union organization among these groups is either very weak or non-existent. Among spatially marginalized populations, the organizations that do form are exogenous and to some extent paternalistic, and are heavily reliant as institutions on the State or the Church. In any event, these organizations are usually established as part of an effort to solve a specific problem (often having to do with demands for urban services) and generally disappear again fairly rapidly.

The general picture that emerges from this review of the situation is one of declining strength in

various forms of social organization and, hence, increasing fragmentation, which may have to do with the region's growing structural heterogeneity. It is possible, however, that some organizations in certain specialized, sharply delimited sectors may be growing stronger. These organizations act in isolation from one another and display a markedly defensive corporate orientation.

## 6. Political organization and representation

The backdrop to this picture of mounting structural heterogeneity and fragmentation, however, is a system of political representation which has apparently been expanded by the widespread democratization process that pushed back the authoritarian wave of the 1970s. As has frequently been remarked upon, this democratization process took place during the severe economic crisis of the 1980s, thereby refuting the old idea that a nation's political "moment" in history will only come after a period of economic growth and of improved social distribution. It certainly did not appear to be a good time for such a development, since democratic freedoms and political participation would give people an opportunity to express their frustration and discontent with the difficult situation. Moreover, not only did the process of transforming the countries' patterns of stratification lead to heterogeneity and fragmentation, but it did so within a climate of social polarization, as the dividing line became ever clearer between those who were and those who were not sharing in the social product of the dynamic sector of the economy.

Under these circumstances, one might think that the mechanisms of political democracy would enable underprivileged sectors to express their demand for greater social balance, and that this might give rise to forms of political articulation that would take the place of the countries' eroded social organizations.

As pointed out by Offe (1988), however, representative democracy, working through the competitive party system, has made it impossible for these parties to give expression to the overall conflict; as they strive to win over undecided voters or members of another party, the political parties' platforms become more and more alike until no significant difference remains. This situation has not, however, been common in Latin America owing to the strong personal influence exerted by some individuals, the marked ideological cast of some political groups, and the weakness, except in a few cases, of the party system in the region.

The democratization process of the 1980s bears the stamp of the political modernization process, which leads to the specialization of political activity and separates it from the idea of the sectoral representation of social interests. This had been its original character when the modern party system was born in Europe with the creation of workers' or socialist parties in the nineteenth century (Cerroni, 1971). All of this has not failed to influence Latin America since the start of its industrialization process.

The political modernization of this recent democratization process has been influenced by two crucial factors. One is the above-mentioned change in the social structure, which made the formation of a community of interests less likely, reduced the opportunities for social organization and made it more difficult to carry such positions over into the political arena. The other event was the crisis and apparent collapse of socialism, which has deprived the working class of a radical alternative to the prevailing scheme and has taken away the party system's main point of reference.

These two events contributed directly to the transformation of the party system as the parties swiftly began to lose their traditional role as sectoral representatives. This, in conjunction with the chronic weakness of the party system in a number of the countries of the region, soon produced the effects identified by Offe. This situation was compounded by the marked independence of so-called political representatives, especially at the highest levels, who performed a complete about-face in their positions.

Against this backdrop, the chances of obtaining political representation of the people's interests is virtually nil, especially in the case of the more marginal groups subject to an increasing degree of fragmentation. At the same time, the chances have increased that the political class may manipulate the masses, thereby generating tension and instability even if this occurs within groups advocating the same political and social agenda.

It is still too soon to predict the future course of this process. It does, none the less, appear to be moving in the general direction of a form of exclusion that would be backed up by an increasingly self-centred political system. Given the conditions described above, apathy is likely to take the place of hopeful participation in democratically-structured political systems. These social conditions leave a number of options open, however; one such possibility

that cannot be ruled out is the emergence of some sort of populism or other alternative to a democratic system if that system fails to develop mechanisms for

social and political representation in keeping with the sweeping structural changes now taking place.  
(Original: Spanish).

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**AUGUST 1993**

**ECONOMIC  
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THE CARIBBEAN**

**C E P A L**

**REVIEW**

**INDEX  
OF ARTICLES PUBLISHED  
IN NUMBERS 1-50 OF  
CEPAL REVIEW,  
BY AUTHORS AND  
SUBJECTS**

**1976 - 1993**



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## Guidelines for contributors to *CEPAL Review*

The editorial board of the *Review* are always interested in encouraging the publication of articles which analyse the economic and social development of Latin America and the Caribbean. With this in mind, and in order to facilitate the presentation, consideration and publication of papers, they have prepared the following information and suggestions to serve as a guide to future contributors.

—The submission of an article assumes an undertaking by the author not to submit it simultaneously to other periodical publications.

—Papers should be submitted in Spanish, Portuguese or English. They will be translated into the appropriate language by ECLAC.

—Papers should not be longer than 33 double-spaced letter-size pages (US quarto), but shorter articles will also be considered. The original and one copy should be submitted, as should the diskettes, if any (in IBM or compatible Word-Perfect format).

—All contributions should be accompanied by a note clearly indicating the title of the paper, the name of the author, the institution he belongs to, and his address. Authors are also requested to send in a short summary of the article (no more than 250 words) giving a brief description of its subject matter and main conclusions.

—**Footnotes should be kept to the minimum, while bibliographical references and direct quotations should be carefully checked, since they are the responsibility of the author.** It is also recommended that the number of tables and figures should be reduced to the minimum and that they should not duplicate information given in the text.

—Special attention should be paid to the bibliography. All the necessary information must be correctly stated in each case (name of the author or authors, complete title (including any subtitle), publisher, city, month and year of publication and, in the case of a series, the title and corresponding volume number or part, etc.).

—The editorial board of the *Review* reserve the right to make any necessary revision or editorial changes required by the articles.

—Authors will receive a courtesy copy of the *Review* in which their article appears, plus 30 offprints of the article, both in Spanish and in English, at the time of publication in each language.



## Recent ECLAC publications

### Periodic publications

**Statistical Yearbook for Latin America and the Caribbean, 1992 edition (LC/G.1747-P)**, bilingual Spanish/English, Santiago, Chile, March 1993, 778 pages.

The 1992 edition of the *Yearbook* contains an updated selection (to the end of December 1992) of the main statistical series available on the economic and social evolution of the countries of the region.

This publication consists of two parts. Part One comprises derived socioeconomic indicators (growth rates, proportions or coefficients) which provide a summary overview of each area of interest. These areas are: social development and welfare, economic growth, domestic prices, external trade, and external financing.

Part Two gives historical series in absolute terms, so that they can be used for a wide variety of purposes. This part includes statistical series on population, national accounts, domestic prices, balance of payments, external financing, external indebtedness, external trade, natural resources and production of goods, infrastructural services, employment and social conditions. Various estimates for 1992 are presented in an Annex.

**Economic Survey of Latin America and the Caribbean, 1991, volume II (LC/G.1741/Add.1-P)**, Santiago, Chile, December 1992, 602 pages.

This second volume of the *Economic Survey of Latin America and the Caribbean, 1991*, contains separate analyses of the economic evolution of each country in the region in the year in question. Volume I, which reviews the main trends in the region's economy, was published three months earlier (in September 1992).

### Other publications

**Reestructuraciones y privatización de los ferrocarriles. Resultados de un simposio (Railway restructuring and privatization: Proceedings of a symposium) (LC/L.727)**, Santiago, Chile, April 1993, 308 pages.

In Latin America—earlier than in other developing regions—government authorities, railway administrations, legislatures and the general public are recognizing the urgent need to make profound reforms in railway companies. This book provides a summarized version of some of the papers and presentations put forward, together with a summary of the discussions, at the

Symposium on Railway Restructuring and Privatization in Latin America, held in conjunction with the Twenty-eighth Regular General Assembly of the Latin American Railways Association, which took place in Santiago, Chile, from 24 to 26 November 1992 and was attended by Latin American government officials, with contributions from international and regional experts.

In Part One of the report, chapter I summarizes a World Bank study which provides a conceptual framework for analysing the options open to governments for restructuring their railway companies. Chapter II gives a summary of aspects connected with the charges for use of the infrastructure levied on the bodies responsible for running trains, when the "highway model" is adopted; a separate chapter was devoted to this subject because of the importance assigned in the symposium to the separation of permanent way administration from the actual provision of railway services, as a restructuring option. Chapter III seeks to provide a general overview of the other issues dealt with at the symposium, so as to place the structural reform of railways within the broader context of the survival of railway companies.

Part Two groups together the presentations designed to give an up-to-date picture of what has been done so far in Argentina, Chile, Colombia and other Latin American countries, as well as in Germany and Sweden, to restructure rail transport on new legal and institutional bases which make possible greater efficiency and transparency of resource use.

Part Three presents studies of methodological interest. The first of these gives the methodology for determining avoidable costs used in preparing tariffs applicable to contracts between the National Passenger Railroad Corporation of the United States (Amtrak) and the other railway companies of that nation. The second study describes the way in which infrastructure management has been established for the Spanish National Railway System (RENFE), from the standpoint of the relation between the competitiveness of rail services and the quality of the infrastructure. The third study outlines methodological aspects connected with the deregulation of railway operations when management of the rail infrastructures is separated from the services proper. The fourth study describes, on the one hand, the relation between variations in infrastructure maintenance costs and variations in traffic and, on the other, the variation of such costs as a function of changes in speed and load per axle for various qualities of permanent way. The fifth study presents a simulation model for financial calculations on aspects connected with a railway concession which gives equity participation to the workers and the government. Finally, the sixth study describes a model for calculating tariffs for railway use which takes account of aspects of the efficiency of the national transport policy.

An appendix gives the text of directive No. 91/440/EEC of the Council of the European Communities, dated 29 July 1991, which contains patterns for the development of the Community's railways.

**Análisis de cadenas agroindustriales en Ecuador y Perú (An analysis of agroindustrial chains in Ecuador and Peru) (LC/G.1963-P)**, Santiago, Chile, April 1993, 294 pages.

This publication contains two studies on policies for developing agroindustrial chains. The first of these deals with the case of

quinua and maracuyá in Ecuador and is preceded by an analysis on agroindustry and related policies. Particular attention is devoted to the agroindustrial chain for each product, and the study concludes with an examination of the factors which facilitate or hinder exports, including exchange rate, customs, fiscal, financial and marketing support measures.

The second study concerns frozen asparagus in Peru. It begins with some conceptual considerations on the basic criteria for designing a sectoral and company-level policy aimed at strengthening agroindustrial chains. It goes on to consider the functions and activities involved in the basic phases of the agricultural export process, also analysing the experience and perceptions of the domestic economic agents. In conclusion, it examines policy options for strengthening the agroindustrial chain.

**El impacto económico y social de las migraciones en Centroamérica** (The economic and social impact of migrations in Central America) (LC/G.1738-P), "Estudios e Informes de la CEPAL" series, No. 89, Santiago, Chile, March 1993, 78 pages.

In the light of the magnitude and intensity of the migrations which took place in Central America in the 1980s, this study tries to estimate their economic and social effects. In this first attempt to gain an idea of an extremely complex phenomenon which varies greatly from one country to another, the aim is to provide an overview of a problem which affects the whole of Central America. The study analyses the consequences of the migrations from El Salvador, Nicaragua and Guatemala to neighbouring Central American countries, Mexico and Belize. It also gives some estimates of the effect of these migrations on the product, employment and demand for goods in the various countries of this area in 1988, as well as calculations of the resulting pressures on public expenditure and the outlays of some non-governmental and international organizations, especially the Office of the United Nations High Commissioner for Refugees (UNHCR). Finally, some appraisals are made of the social sequels of the migrations.

The study centres on those who had to become refugees or displaced persons because of violence or extreme economic insecurity. It therefore excludes those who left their countries before the 1980s (for example, the hundreds of thousands of Salvadorians who moved to Honduras in previous decades and the large number of agricultural workers who emigrated from Eastern Guatemala). Nor does the study take account of refugees who went to countries outside Central America, especially those now living in the United States, who amount, according to some estimates, to over one and a half million persons.

The existence of big migratory flows is nothing new in Central America. There have traditionally been movements from rural areas to the cities, seasonal movements of workers at times of sowing and harvesting (of coffee and cotton, for example), and migratory flows from the most densely populated countries – particularly El Salvador – to neighbouring nations. More recently, these movements have been intensified by the economic crisis and political violence, which have also changed their target directions and their nature.

Social pressures, which had been moderated by the vigorous growth of the Central American economies during the

period 1950-1970, surged up strongly in the crisis-ridden 1980s, leading to violent political conflicts which, in turn, caused massive migrations which were quantitatively and qualitatively very different from the traditional population movements, since they generally affected people living in conditions of extreme poverty in their places of origin, who, when they emigrated to rural areas or peripheral urban areas outside their countries, came into competition with other marginal groups for consumer goods, services and job opportunities. To deal with this situation, in some cases camps have been organized in which the immigrants receive assistance from governments and non-governmental organizations. In 1988, some 200 000 refugees and repatriated persons were receiving support from the international community, 75% of which came directly from the Office of the United Nations High Commissioner for Refugees (UNHCR).

The phenomenon of Central American migrations has further aggravated the long-standing poverty of most of the countries of this region. The profound economic crisis, which has already lasted for more than a decade, and the efforts of governments to stabilize their economies by reducing fiscal deficits have led to severe cuts in social expenditure which have not been fully offset by increased public and private international aid. The tragic situation of the exiled population groups is further aggravated by the shaky conditions prevailing in the communities which receive them. Countries which – with only a few exceptions – are unable to satisfy the basic needs of the major part of their own population must now also shoulder the burden of massive population shifts within their own borders or the arrival of refugees from other countries. The dilemma is how to meet the basic needs of the new immigrants and integrate them temporarily or permanently into the local economy without lowering the standard of living of the host communities or generating rejection of the newcomers.

The migrations in Central America are no longer seasonal or temporary: mechanisms have now arisen which favour the permanent location of the immigrants (for reasons which include the desire to reunite families). As long as the crisis still exists, the flow of domestic and foreign displaced persons will continue to grow. In any case, the economic, social and political effects of these population flows, which already involve over 10% of the total Central American population, will continue for a long time to come.

The categories dealt with in this study – refugees, displaced persons, and repatriated persons – are not unchangeable, definitive concepts, since there is a pattern of mobility and change in the migratory flows. In some cases, domestic displaced persons – especially young people – leave their place of origin and become refugees in neighbouring countries, subsequently setting off for the United States or Canada. Frustrated expectations cause many of the migrants to move from one area to another and, eventually, to go abroad. The process is a painful one and has high social costs.

These factors make it more difficult for the population to go back to their places of origin, even when the political and economic situation there has returned to normal. In other cases, the place from which the emigrants originally came suffers from such widespread poverty that it is difficult to reincorporate those who come back. Thus, the praiseworthy objective of securing the return of the displaced persons and exiles may be very difficult to fulfill.

**El comercio de manufacturas de América Latina: evolución y estructura 1962-1989** (Latin American trade in manufactures: evolution and structure 1962-1989) (LC/G.1731-P), "Estudios e Informes de la CEPAL" series, No. 88, Santiago, Chile, November 1992, 150 pages.

This study contains a comparative analysis of Latin American and Caribbean trade in manufactures with other regions of the world. It is centered mainly on the preparation of a classification of trade flows which is then used to evaluate Latin American trade over the last 25 years and to make various comparisons with the results obtained by the industrialized countries and the developing countries of other regions of the world, especially those whose strategies of incorporation into international trade have been considered as models.

The analysis of the Latin American and Caribbean external sector carried out on the basis of the trade classification selected confirms the trends with regard to exports of manufactures and the one-sided nature of such trade already identified in previous ECLAC studies based on the traditional classification; however, the breakdown by types of products has made it possible to identify new features of the trade flows which were not hitherto well known. In this way, it was possible to determine the exact nature of the region's form of incorporation in international trade over the last thirty years, which casts a good deal of doubt on the real magnitude of the achievements identified in the past.

Latin American and Caribbean exports of manufactures registered satisfactory growth rates since 1960, enabling the region to build up a new export structure with greater diversification and a higher technological content. The share of manufactures in the region's exports grew steadily, rising from 5% in 1962 to 30% in 1989, whereas the share of primary commodities went down from 63% to 45% over that period and that of semi-manufactures also declined, although to a lesser extent and with some fluctuations.

However, these results were far below those of some other developing countries, especially those of South-East Asia. The region's exports continued to be very modest (US\$70 per capita in 1989 at 1980 prices), whereas those of the industrialized countries in general amounted to over US\$1 500 per capita, and some of them registered much higher levels. Comparisons with some developing countries which had much lower levels than those of Latin America in the early 1960s were also unfavourable to the latter region.

The region has also managed to improve the technological content of its exports, since the products of new industries, that is to say, those whose activities require highly-skilled personnel, which accounted for less than 2% of total exports in 1962, had increased their share to 15% by 1989. Even though this share increased tenfold, however, the region's exports continue to be quite different from those of the industrialized countries and of the developing countries which have been most successful in their external trade. Thus, in total world exports, the share of new industries came to almost 50% in 1989, and moreover the growth rate of these new exports was higher than that of the products of mature industries. In Latin America, however, the different groups of exports grew at similar rates, so that traditional industries continue to play an important role in export activities, and moreover, most of the exports of the new industries in the region came from only a few branches in a few countries, and many of them corresponded to internal

transactions of transnational corporations, either between branches of such corporations or between such branches and the Head Office. Consequently, the progress made in the region's place in international trade is seen to be much more modest than had appeared from previous studies. This had already been detected to some extent, through various indicators such as those revealing the very limited role of exports by the metal products and machinery and the chemical industries. With the new classification, however, the conclusions are much clearer.

Because of the very limited role played in it by goods of high technological content, Latin America's external trade continues to be one-sided. It has only been possible to reverse the manufacturing trade deficit in the case of traditional labour-intensive mature industries; in all other types of products the deficit continues to be high, because in these cases the region still depends on supplies from the developed countries.

The results registered in the various countries of Latin America and the Caribbean were very heterogeneous. Brazil and Mexico were the most successful countries, because in 1989 their exports of manufactures came to 45% and 40% respectively of their total external sales. These countries also displayed an incipient trend towards increased exports of goods with high technological content –new industries– although the trend was somewhat different in each case. In Brazil, such exports grew very considerably in the 1970s, but subsequently their growth rate markedly declined. In Mexico, in contrast, the biggest growth took place from 1980 onwards, and by 1989 such exports amounted to almost 30% of the total external sales by new industries. A large part of these exports consists of only a few products, however, especially motors. At all events, these results are quite far removed from those achieved by a number of other developing countries which have consolidated their exports of manufactures, both in traditional product lines and in categories of high technological content. Uruguay's manufacturing exports attained a satisfactory level, amounting to 35% of the total in 1989, although two-thirds of them corresponded to traditional products. The results obtained by Argentina were a good deal more modest, with manufactures accounting for less than 30% of total exports.

In the medium-sized and small countries of the region (except for Uruguay and Barbados), exports of manufactures have continued to be very limited. There has even been a certain reversal of previous trends, since in some countries –especially Chile– primary commodities have increased their share of total exports at the expense of semi-manufactures and manufactures. In that country, the share of exports of manufactures in total exports was less than 10% in 1988 –one of the lowest proportions in the region– and only 2% corresponded to products of new industries. However, there has been a greater degree of diversification of commodity exports in Chile, and they include some new products whose marketing involves the incorporation of technical progress (fruit, for example).

*The Caribbean: one and divisible*, Jean Casimir (LC/G.1641-P), "Cuadernos de la CEPAL" series, No. 66, Santiago, Chile, November 1992, 207 pages.

In the Caribbean, the concepts of country, nation and State are not the same as those used in other regions of the world. How a sense of belonging to Caribbean societies is born and developed,

what elements define national identity, and what is the point of convergence of people thus identified are questions to which no answers have yet been given, but which undoubtedly need answering.

There are various corollaries to the queries over the nature of the material and spiritual heritage of the people of the Caribbean. What was noted earlier raises natural doubts as to whether the "national economies" of the Caribbean are likely to have the same features as those of nations which "possess" material resources and have a tradition of defending and developing them.

In the absence of a common heritage, how should political frontiers be viewed, and how is the political authority established which will be responsible for administering what those frontiers should defend? How can the laws of economic development be imposed and come into effect? To what tangible reality should these laws refer? In other words, it should not be taken for granted that the Nation-State – as conceived in the West – will necessarily be the automatic successor of the types of colonial State which the Caribbean has known in the past.

This study describes the evolution of the social structures of the Caribbean, placing emphasis on the existence of a dual – creole and local – process of formulation of social objectives. The "common" objectives supposedly pursued through planning are not those of society as a whole. As this has not been understood, the planning methods used are blamed for the scant progress in the application of development plans and programmes. At the same time, negotiations carried out at different rates and under different rules give rise to another set of objectives which the population seeks to obtain without reference to the authorities.

The existence of two sets of social objectives frustrates efforts at planning, no matter how well-intentioned they may be. Survival strategies are instituted, official policies are rejected or ignored, and social sector planners run into insuperable resistance to participation on the part of the popular sectors.

The Caribbean States are currently faced with the need to legitimize new power structures and establish new relations with local civil societies. This study describes the differences in outlook of nations as tiny as those of the Caribbean, together with the shortcomings in the current form of social cohesion, and shows how that imperfect cohesion makes possible a dialogue between governors and governed which facilitates the participation of the former metropolitan countries in these family conversations, but does not ensure that of all the members of the family.

This study avoids normative analyses: it does not talk about the right of nations or individuals to economic and social development, or about the injustice and exploitation they are subjected to, but instead simply seeks to describe the logic of regional evolution.

After the introductory chapter, the study analyses the creole, who, according to the theories in vogue, is the main social actor in the region. It examines the type of workers who succeeded the slaves, and shows their differences with wage workers. It analyses the structure of regional unity on the basis of the patterns of behaviour of the human groups involved. It outlines the advances made towards various forms of consensus and identifies the local institutions which seem to help support the social cohesion of the nation. It goes on to refer to the

reproduction of structural dualism, in spite of greater integration of the systems of production, and describes the mechanisms for the production and reproduction of poverty. Finally, after positing the existence of two kinds of civil society, as already suggested in the introduction, it concludes with an analysis of the relationship between systems of government and national culture.

**Las finanzas públicas de América Latina en la década de 1980** (Latin American public finances in the 1980s) (LC/G.1737-P), "Cuadernos de la CEPAL" series, No. 69, Santiago, Chile, August 1992, 100 pages.

This study analyses the series of maladjustments and adjustments suffered by the public finances of Latin America in the 1980s.

In order to cope with this dramatic fiscal crisis, the Latin American countries had to pass through numerous far-reaching fiscal adjustment processes in the past decade. The biggest of these processes affected 14 of the 19 countries of the region for which information is available. Many of these adjustment processes were a failure, while others, although relatively successful, have proved to be quite fragile, so that they have still not been able to restore the situation which existed in the late 1970s. The crisis was due largely to the specific conditions of each country, but certain features are common to all of them, including the high fiscal deficit, the restrictions on tax policy, the lagging scales of charges and consequent de-financing of public enterprises, the new obligations which States have had to assume, the reversal of net external resource transfers, the difficulties in financing the fiscal deficit, and the serious deterioration in public functions, which in some cases has practically meant the collapse of the State.

The crisis of the public finances in the great majority of Latin American and Caribbean countries was one of the most prominent features of the economic crisis suffered by the region in the 1980s. It was reflected in particular in the severe difficulties experienced in public sector financing due to the heavy deficits registered – aggravated by recession and the debt burden – and the sharp fall in external financing. This situation caused governments to apply various combinations of inflationary financing, suspension of debt service payments and fiscal adjustments in their economic policies during the decade. From a structural point of view, however, the financial crisis of the public sector highlighted the vulnerability of fiscal structures to external upsets and internal pressures, and their growing inability to apply public policies aimed at achieving stability, development and equity.

The relation between economic performance and fiscal policy has worked in both directions. On the one hand, the public finances have directly affected the basic macroeconomic imbalances registered in the balance of payments, the domestic absorption of resources, and the evolution of inflation. On the other hand, the prolonged macroeconomic instability and the magnitude of the adjustment made necessary by external upsets have had their effect on the economic and financial behaviour of the public sector. As the adjustment became more severe, financing the fiscal deficit became an increasingly complex matter. The evolution of the public sector and the fiscal deficit in Latin America have also reflected the interaction between

active fiscal policy associated with decisions of the fiscal authorities and developments affecting the fiscal sector which are beyond the control of the authorities but nevertheless affect public sector management.

Budgetary policies have been a prime factor both in giving rise to the external indebtedness which began in the late 1970s and in the difficulties presented by the subsequent adjustment process.

The prevailing climate of uncertainty and the widespread capital flight with which many Latin American economies have had to cope have also favoured the spread of unregistered activities, thus helping to further reduce the tax base. Likewise, the subsequent absorption of the private debt in the public accounts, because of the impossibility of paying it, became yet another burden on the State budget which still persists today. Rescue operations to bail out the private sector have taken place in almost all the countries of the region with a high level of indebtedness. The transfer mechanism used to provide this subsidy has been the public budget or various kinds of monetary instruments (rediscounts, exchange rate insurance) made available by the Central Banks, thus subsequently leading to a big increase in the quasi-fiscal deficits of the issuing bodies.

Exceptions to the above rule are a few Latin American economies which had a relatively sound fiscal situation before the transfer of external resources suffered an abrupt turnaround due to the suspension of external finance.

The end of the 1970s found the Latin American economies in a much more complex situation than in earlier years: fragile financial systems wide open to the exterior, vulnerable exchange rate policies, falling terms of trade, etc. These factors are important not only when taking a retrospective view of the problem of external indebtedness in relation to the fiscal crisis, but also in order to gain a fuller idea of the effects of the external debt on public finances and indeed on domestic macroeconomic equilibrium itself, especially as from the time (1981-1982) when the countries of the region had to cope with a situation of extremely scarce external credit.

Early on in the crisis there was a fall in fiscal income as a result of the recession, which made it necessary to take tax measures to offset its effects. The scales of charges of public services also generally lagged behind during inflationary processes, thus further accentuating the financial difficulties of public enterprises. Current outlays, however, tended to rise, partly because of interest payments on the public debt. In the early years of the decade, the financial burden of the external debt was also increased by the increase in real exchange rates (one of the main instruments for adjusting the external accounts) and the rise in international interest rates.

Subsequently, the costs of the domestic debt rose significantly because of the exceptionally high interest rates. In the light of the growing fiscal deficits, it was decided to cut outlays in the areas where this was easiest but involved high social costs: public investment and social expenditure.

The fiscal crisis had been brewing for some time, because of the structural fragility of the public systems due to the instability of their revenues and the rigidity of their expenditure. During the 1970s, however, it had been possible to cover the deficits through the easy availability of external resources, which permitted the postponement of the necessary fiscal adjustments. When this situation was reversed in the early 1980s due to the suspension of external credit flows, especially

from the commercial banks, and the incidence of other factors such as the rise in international interest rates, the heavy external indebtedness of the countries of the region, and the slump in commodity export prices, this quickly set off an economic crisis of a severity unknown since the Great Depression of the 1930s. Because of the combined effect of these factors, the net flow of credit resources—which had been favourable to the region in the 1970s—became negative. The economic recession sparked off in order to adjust the external accounts further accentuated the crisis and adversely affected fiscal revenues, so that the public sector deficit grew considerably.

Moreover, the turnaround in the net flow of resources not only made necessary stringent adjustments in the external accounts but also gave rise in the great majority of the countries to an abrupt change in the financial situation of the public sector, which, after having been the main recipient of such resources, was forced to assume the prime responsibility for finding funds to pay the net outlays demanded.

In addition to all these difficulties, the external debt crisis had yet another negative impact on the public accounts, since governments had to assume responsibility, through various mechanisms, for much of the private sector's external indebtedness. The sudden interruption of the flow of external credit to the region was a serious blow to debtors and financial intermediaries with heavy foreign currency liabilities: the automatic rolling over of credits ceased abruptly and they were therefore unable to meet their liabilities as they fell due, so that most of them entered into arrears. The problem was further aggravated by domestic recession and the substantial rises in real exchange rates. In view of this generalized state of insolvency, the Central Banks of many countries had to step in with subsidies and debt reprogramming facilities in order to avoid the total collapse of the financial system.

**Canales, cadenas, corredores y competitividad: un enfoque sistémico y su aplicación a seis productos latinoamericanos de exportación** (Channels, chains, corridors and competitiveness: a systemic approach applied to six Latin American export products) (LC/G.1732-P), "Cuadernos de la CEPAL" series, No. 70, Santiago, Chile, August 1992, 183 pages.

This study analyses the spatial and temporal distances and obstacles which have to be overcome in order for a Latin American product to reach international markets on competitive terms. The empirical basis for the study is a series of eight monographs, six of which correspond to case studies on Latin American exports, while the other two analyse port problems in Latin America and Chile's experience in modernizing its ports.

In order to carry out a suitable examination of the many complex activities which must be carried out in order for a Latin American product to reach consumers on another continent, and which must be improved as far as possible if the product is to be competitive, a **Latin American Export Marketing Model** was prepared and used as a basis for analysing the question.

In this model, a marketing channel is defined as a set of economic agents which carry out the activities needed in order to permit an object produced in one place to be used or consumed in another. The agents and activities may be grouped according to specific aspects of the export operation. When the activities are carried out consecutively over time, the resulting group is called a chain, otherwise it is called a flow.

The basic marketing channel is made up of the flow of negotiations on the conditions of sale of the product, the production stage, the insurance flow, the export financing flow, the physical distribution flow, the information and documentation flow, and the consumption or use of the product. The marketing system is the set of all the marketing channels which exist in a country in order to allow a product to reach the consumer.

Marketing channels are not isolated bodies, as their environment directly and indirectly affects them. Some elements which are particularly important for international trade have been extracted from this environment to make up the concept of international trade corridor.

An international trade corridor is a set of four components which interact with each other and with the rest of the environment in order to make possible both the exports and the imports of a country. These four components are trade and financial rules and practices; government requirements; the infrastructure, vehicles, equipment and installations; and finally the actors themselves.

The actors can be grouped according to the nature of the services they provide. For the purpose of the model, six groups of services have been considered: i) physical distribution, including transport; ii) product promotion and sale; iii) finance; iv) insurance; v) communications and telecommunications; and vi) support services for complying with government requirements and trade and financial rules and practices. There is also a seventh group of actors, made up of public or private regulatory and control bodies.

One of the virtues of the model is that it clearly brings out the mutual relations between the chains and flows making up the marketing channels, between the marketing channels themselves, between the international trade corridors and the channels, and between all the above elements and the trade environment. When the analysis is put in this way, it can explain a number of mutual influences between the chains, flows, channels, corridors and the surrounding environment which would otherwise have to be considered as mere data, since they do not form a direct part of the elements in question.

In the initial stages of exports, external demand (especially from the industrialized countries) was a decisive factor in their subsequent success. Most of the exporters began with a product which found a favourable place or "niche" on external markets, after which they grew and diversified. Another factor of great importance was that real or potential consumption of the product initially exported was high (especially in the case of the United States market), at least compared with the scales of production of Latin American exporters.

Wage levels in the five countries producing the six types of goods studied are lower than in the importing countries, and this has been an important factor in the competitiveness of these products. Moreover, in almost all cases the level of productivity has been sufficient to compete with countries where lower wages are paid. Natural comparative advantages have been particularly important in the case of exports of agricultural products, but it has proved possible to turn the comparative advantages in the production process and, more generally, in the country of origin, into competitive advantages when exporters have been able to use efficient international trade corridors and marketing channels to sell their goods on international markets.

The impression is that macroeconomic policies, and above all their stability over time, have been more important than specific policies aimed at a particular sector. All export efforts need time to mature and produce the desired results. The economic agents are willing to take risks, but they operate with greater security when the rules are clear and stable for a sufficiently long time to permit businessmen to verify the profitability of their investments.

The effect of the production process proper on competitiveness may be considered as being much less than that of other factors. In all the cases studied it was observed that most of the final value of the product on its destination market is accounted for by the intermediate stages between production and consumption, and it is the intermediaries who gain the biggest profit margins.

Intermediaries have always played, and continue to play, a much more important role than is usually credited to them in export activities. They were of decisive importance in the early stages of the sectors studied, except in the case of clothing manufacture in Colombia, and they continue to be very important now that export volumes have grown considerably in almost all cases.

The most valuable contributions of the intermediaries (especially those from abroad) have been their business and financial capacity, their leadership, and the new technology and knowledge of international markets they have provided: indeed, the establishment of efficient physical distribution chains and the growth in exports of some products have been largely due to their participation.

In order to overcome the spatial and temporal gap between production and consumption, the action of intermediaries is indispensable. As it is impossible for every producer to establish contact with every consumer, the presence of intermediaries in the marketing channels is no more than a reflection of the underlying logic of national and international trade. This presence depends basically on the degree of specialization of the activities to be performed, the financial resources involved, the economies of scale that can be attained, and the characteristics of the product.

It would be an error to try to cut out intermediaries on principle, but it is very important that there should be competition among them in international trade corridors, so that the differences in bargaining power among the actors do not lead to loss of profits by the producers. It should be noted in this respect that in the analysis of the six cases anomalies were found in the distribution and transfer of the risks involved, in that some economic agents assume risks which would not appear to be inherent in their line of activity.

Increasing and consolidating their sales has demanded a great effort from exporters in terms of improving the quality of their products, since as the volume of exports has grown, this has become an item of crucial importance for intermediaries and buyers. Quality standards on the markets of the industrialized countries, which are different from those existing in Latin America, have constantly risen, while the degree of tolerance for products which do not meet them has gone down. In fashion products, such as women's clothing and footwear, these demands may change even in a few months. For exporters, improving quality means to a large extent exporting products which are properly standardized in every respect.

Consequently, by improving quality exporters have gained access to new segments of the marketing systems which are generally more demanding than those encountered at the beginning, and at the same time they have avoided a situation where increased export volumes have been reflected in a severe fall in prices. The reality that all exports have had to face sooner or later is that of shrinking profit margins with a simultaneous increase in quality requirements. The fact is that export growth can only be maintained if it is accompanied by an appreciable improvement in quality. The problem of marketing lower-quality products has also become more complex in this respect, since exporting them to industrialized countries is no longer a profitable business.

The diversification of exports in terms of both products and markets has largely been the result of the exporters' initial success, which aroused interest among importers in receiving a wider range of products and attracted orders from importers in other markets for the products which were already being exported: thus, diversification of products and markets became an obligation. The case studies revealed that in this stage the physical distribution chain had ceased to be a limiting factor, so that exporters were not only able to send their products to new markets but were also able to gain access to new segments of the marketing systems.

An extremely important change had taken place in the marketing channels. After a situation in which the flow of negotiations on terms of sale had been a function of the physical distribution chain, the latter chain became itself a function of the flow of negotiations on terms of sale.

As the volumes exported grew and product quality improved, exporters were in a position to send their products to

their destination through new marketing channels. Thus, on the one hand they were able to attain economies of scale, or something similar, while on the other hand they were able to gain access to more demanding segments of the marketing systems, so that the bigger volumes exported did not necessarily lead to comparable declines in prices.

As long as export volumes were only small, exporters normally had to make do with the existing international trade corridors, but when those volumes increased exporters were able to exert influence on the corridors and even set up their own specialized corridors, without using the existing ones.

It may be noted that the search for efficiency in marketing can help favour the integration of activities among some economic agents: thus, inefficient links in the marketing channels are usually discarded, and some agents themselves begin to carry out the previously unsatisfactory activities, partly because, on account of their size, they are well prepared to handle large volumes of products or to cope with the requirements raised by those volumes.

Perhaps the most important result of the present study is that it has made it possible to bring out the mutual interactions between the physical distribution chain and the other chains and flows making up the marketing channels: thus, the physical distribution chain cannot be viewed as an isolated element in exports.

The model helps in understanding a number of decisions which are difficult to understand if only physical distribution is considered, but the study of specific aspects of the latter does not necessarily mean, of course, that exhaustive analysis of the marketing channels of international trade corridors and of the rest of the export environment is not also called for.





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