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RESTRICTIONS ON SUSTAINED DEVELOPMENT IN LATIN AMERICA AND  
THE CARRIBEAN AND THE REQUISITES FOR OVERCOMING THEM



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## FOREWORD

Since the beginning of the present decade, the countries of Latin America and the Caribbean have been facing a series of restrictions on sustained growth, against the background of an unusually prolonged economic crisis. For its part, the Secretariat has taken the position that it is neither realistic nor advisable to expect a solution to that crisis to come from outside.<sup>1/</sup> Notwithstanding the adverse conditions, the countries of the region cannot resign themselves to the perpetuation of this situation and must tackle, mainly by their own efforts, the many obstacles to recovery and development.

However, in the face of the persistent and simultaneous phenomena of depressed prices for the region's basic commodities, a heavy debt servicing burden, and reduced levels of fresh external financing, all of which are reflected in the transfer of financial resources abroad which affects many of the countries of the region, the margin of autonomy in the formulation and implementation of economic policies, while capable of expansion through intra-regional co-operation efforts, is nevertheless extremely limited. Even more serious is the fact that this situation creates new and difficult dilemmas, since the principal response which the countries of the region can adopt --diversification and modernization of their productive capacity-- in order to qualitatively change their form of insertion in the world economy and to achieve equitable development based on the dynamic satisfaction of basic needs requires, in the final analysis, fresh investments whose financing is limited by the external restrictions in question.

Consequently, the main thrust of this paper concerns the possible ways of tackling this series of constraints reflected in the phenomenon of the negative transfer of resources, both through national and regional efforts and within the framework of multilateral co-operation. What is involved is a particular perspective which will permit us to survey anew the broader range of options for overcoming the crisis in the short term and to meet once again the challenges of development in the medium and long term.

In this regard, this paper presents three main conclusions. The first is that the servicing of the external debt, while not the only obstacle to development in the region, has become the greatest impediment to the achievement of expansionary adjustment and lasting stability, which are indispensable conditions for overcoming the stagnation that has characterized the majority of the region's economies during the present decade. The second conclusion is that, while it is very necessary to overcome this impediment, this in itself is not sufficient to set countries once again on the path of development. To do so requires a set of changes, the broad features of which are summarily outlined in the following pages on the basis of previous

studies.<sup>2/</sup> Finally, overcoming the crisis requires a judicious combination of short-term economic policies and medium- and long-term changes, which, in turn, requires more effective co-ordination between the management of macroeconomic balances and the planning of public activities.<sup>3/</sup>

## I. THE RESTRICTIONS ON SUSTAINED DEVELOPMENT

### 1. The features and scope of the crisis

Since 1981, as the Secretariat has noted in numerous documents, various formulas have been attempted in Latin America and the Caribbean --some of them conventional and others more unorthodox-- in order to adjust the economies and surmount the crisis, which is characterized by, inter alia, an incapacity to achieve sustained growth in a context of reasonable stability. Notwithstanding the limited progress achieved since 1985 in what is still a minority of countries --progress which, in any event, has for the most part been partial and inadequate, and achieved at the cost of great social sacrifices-- the crisis has not been overcome.

Thus, despite the great diversity of situations that characterizes the region today, the majority of countries --large and small, relatively more or less developed, and independently of the mix of economic policies adopted-- have not managed to achieve sustained growth since the beginning of the decade, and many of them have not recorded any growth at all.<sup>4</sup> Among those which did record some growth, this was almost always achieved at the price of an eventual worsening of the external imbalance, and/or an upswing of inflationary pressures. Moreover, far from coming closer to the goal of more equitable growth, the countries have been drawing further and further away from this, since generally speaking the effects of the crisis have been markedly regressive. In other words, the crisis has been extremely resistant to solutions of the most diverse scope and content, mainly on account of the tremendous weight of the obstacles and impediments to recovery, and what is worse, these obstacles and impediments seem to be growing more severe with the passage of time owing to their cumulative character.

### 2. Restrictions of external origin

Among these constraints, those of external origin, which have historically had a decisive influence on the behaviour of the economies of the region, assumed particularly adverse dimensions in the 1980s. As is well known, these dimensions include: firstly, the high level of uncertainty and unpredictability of the international financial and trading system, which is due in part to unresolved tensions in the co-ordination of the economic policies of the major member countries of the Organization for Economic Co-operation and Development (OECD) and which is reflected, inter alia, in fluctuating exchange rates, the intensification of protectionist pressures, and relatively slow rates of economic growth; secondly, the noticeable falling

off in the transmission of the dynamic impulses of world trade to the countries of Latin America and the Caribbean: during the period from 1980 to 1987, the region as a whole increased the volume of its exports by 32%, devoting a significant part of its efforts to this, but with the net result of a 1% decline in the value of its exports; thirdly, the increasingly heavy burden of servicing a huge foreign debt, magnified by the exceptionally high levels of international interest rates during most of this period; and, finally, the abrupt drop in the levels of fresh external financing, made worse by the procyclical behaviour of private capital (contraction of direct foreign investment and, particularly during the period 1981-1984, the increase in the flight of private capital from the region).

Compelling evidence of how these interdependent features --over some of which the region has had little or no control-- have affected Latin America and the Caribbean is the fact that in 1986, when the average terms of trade index had fallen to its lowest level in recent decades,<sup>5/</sup> at the same time the countries of the region as a whole transferred financial resources abroad in amounts averaging nearly 4% of their gross domestic product.<sup>6/</sup> Since, historically, the region as a whole received net resources from abroad equivalent to 2% of its gross domestic product, the reversal in the transfer of resources has been overwhelming and has become the central factor conditioning the economic performance of many Latin American and Caribbean countries (see figure 1).

### 3. Restrictions of internal origin

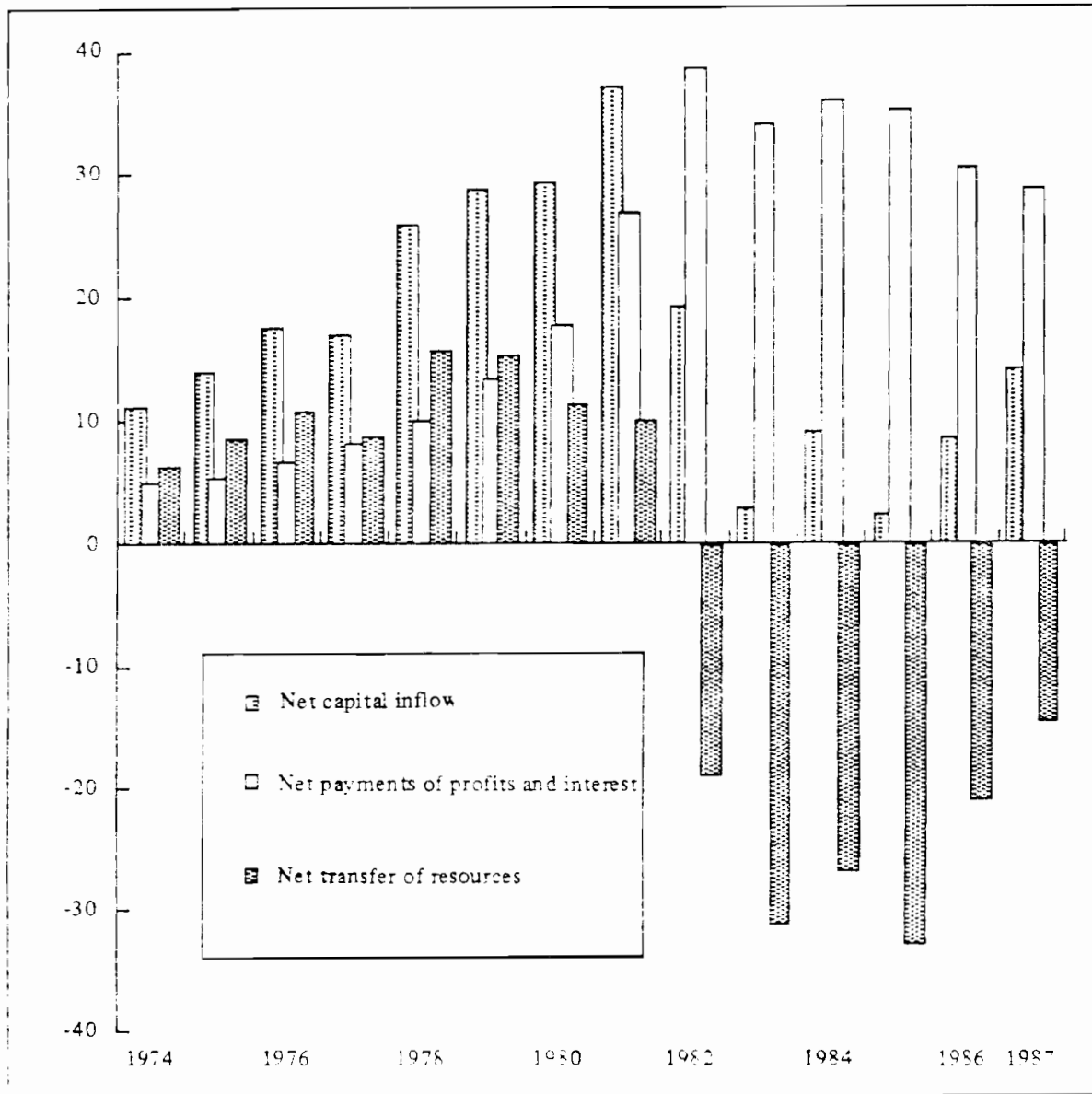
The constraints of internal origin, for their part, are indissolubly linked to phenomena of external origin. Some of them have existed for many years while others are the product of the current economic situation. The latter are reflected in the persistence of basic economic imbalances, notwithstanding the vigorous efforts made since 1981 in the area of adjustment and stabilization of the economies of the region. The turnaround from the traditional situation of a trade account deficit to a surplus situation for the region as a whole, in order to cover, inter alia, the servicing of the external debt, was achieved largely through a drastic cut-back on imports, at a rate even higher than the rate of evolution of the gross domestic product, and this is consequently reflected in the depressed levels of domestic demand, and particularly that of the majority groups of the population.

In this regard, notwithstanding the significant progress achieved in 1985 in reducing inflation, by the end of 1987 there had been a resurgence of inflationary pressures in many countries, and furthermore levels of inflation were generally much higher than those recorded prior to the crisis. To some extent, the very adjustment policies adopted, and particularly those relating to exchange rates, contributed to the resurgence of those pressures. In short, having regard to the complexity of the obstacles confronting the economies of the region, the latter have not been able to achieve growth, external balance and price stability all at the same time.<sup>7/</sup>

Furthermore, the declining levels of investment and saving have become clear limiting factors for the growth potential. Between 1981 and 1986, the proportion of the product devoted to investment went down from nearly 24% to

Figure 1

## LATIN AMERICA: NET CAPITAL INFLOW AND NET TRANSFER OF RESOURCES

*(Billions of dollars)*

Source: ECLAC, on the basis of figures supplied by the International Monetary Fund.

16%; the areas of activity most affected by the reduction in capital formation have been those connected with the physical or industrial infrastructure. The prolonged postponement of investments in these fields usually leads to a deterioration which later makes recovery a more costly matter. Moreover, the recovery or even raising of the level of the product achieved by some countries has been secured by combining fuller use of installed capacity and investments in sectors of low capital intensity, and this method tends to be rapidly exhausted with the passage of time. Thus, any effort to grow will initially require substantial amounts of capital --far above the amounts that would have been needed to achieve the same growth rates in the conditions of 1981.

Lastly, the current scant capacity of the State to mobilize real and financial resources for development also constitutes a restriction on growth. In most of the countries, the State has been faced with the need to increase expenditure in order to finance interest payments on the debt. On many occasions it has also assumed responsibility for solving the financial crises suffered by the private banking system and by many productive enterprises. On the other hand, its income from taxes has been reduced on account of the drop in the level of economic activity. Consequently, in budgetary terms, governments have had their capacity for manoeuvre restricted to minimum levels, in particular as economic agents responsible for public investment, which has been the component of fiscal expenditure most affected by the adjustment programmes implemented. At the same time, these restrictions have contributed to the disarticulation of the institutions and public enterprises referred to below.

As regards the long-standing restrictions, despite the diversity of situations existing in the region, a number of phenomena have occurred which, to different degrees, affect the majority of the countries. In this respect, mention should be made first of all of the apparent exhaustion of the principal sources of dynamic impulses of the long period following the war. It has already been noted how external demand, far from fulfilling its role as a stimulant to growth, has been transformed today into a mechanism for transmitting recession. This phenomenon is due to complex factors in both the individual countries and the international economy, including the high level of dependency of the export sector of Latin America and the Caribbean on primary products, the demand for which in world markets has been characterized by downward trends. Furthermore, the vital need of the countries of the region to generate foreign exchange has led them, in many cases, to boost the volume of their exports of raw materials, and this became one of the contributing factors to the marked decline in the unit prices of commodities. At the same time, even during the 1970s the process of industrialization began to show clear signs of a loss of dynamism: a phenomenon which speeded up in the present decade.<sup>8/</sup>

Secondly, it is well known that even during the decades in which the region's economies grew in a dynamic and sustained manner, this growth was characterized by a trend towards concentration and by the fact that large sectors of the population continued to live in conditions of extreme poverty.<sup>9/</sup> During the 1980s, which have been characterized by low and even negative growth rates, by high levels of unemployment and particularly underemployment, and by restrictions on wages and salaries, this situation has

undoubtedly worsened. In many countries, the provision of social services has deteriorated --in quality and in quantity-- on account of the financial constraints facing governments, while large sectors of the population which had achieved medium income levels in previous times experienced a marked deterioration in their level of material well-being as a result of the removal of subsidies, lagging wage and salary increases and, in some cases, heavier tax burdens. This phenomenon made the contraction in domestic demand even more severe, particularly in the case of the demand for consumer goods.

Thus, during the present decade the cumulative deterioration in the well-being of the general population has been getting worse precisely at the time when the capacity of the different population groups to voice their demands has improved, as a result of the emergence of increasingly democratic and participatory political processes. The magnitude of these demands, which PREALC has aptly referred to as the "social debt",<sup>10/</sup> has become an additional source of tension in trying to resolve the problem of how to reconcile growth, external balance, price stability, and greater equity, all within the context of a strengthening of the democratic processes in the region.

In addition to the economic constraints already mentioned, reference should also be made to constraints of a different kind. As regards the question of the conservation of natural resources and the environment, for example, the pressing need to generate foreign exchange has intensified the use of certain natural resources, without any regard for over-exploitation or the pollution arising from the production processes. Consequently, there has been in recent years a worsening of various negative trends such as soil erosion, deforestation and various types of pollution, which are a serious threat to the potential for future economic growth.

In the institutional field, six years of crisis have undermined the operational capacity of the State, already severely diminished in many countries in the early 1980s, and most of the economic agents have organized themselves primarily to deal with financial problems, relegating production-related problems to a position of secondary importance. At the socio-political level, pressure continues to be exerted by majority sectors whose incomes have been significantly reduced and who are struggling to restore them to their former levels, while the high-income sectors seek to ensure that neither their general influence nor their standards of living are reduced.

Finally, precisely at a time when intra-regional co-operation should have represented the greatest hope for surmounting externally originating obstacles common to all the countries of Latin America and the Caribbean, the relations of economic interdependence among these countries (at least when measured in terms of their reciprocal trade) have tended to decline. In other words, trade integration has not had the expected effect of compensating for the restrictions imposed on trade with third countries. Rather, the restrictions of external origin and the policy measures adopted by countries to deal with them have helped to create a situation in which --in all the subregional integration processes as well as in the region as a whole-- intra-regional trade has declined even faster than total trade.<sup>11/</sup> Nevertheless, it must be noted that over the last two years substantial progress has been made in concluding new integration agreements, particularly at the bilateral level. In this regard, the bilateral agreements between Argentina and Brazil, on the one

hand, and between Uruguay and each of these two countries on the other hand, provide an opportunity for fresh impetus to be given to integration.

#### 4. Changes in the pattern of behaviour of the economies

It is clear from the foregoing that the countries of Latin America and the Caribbean are faced with an accumulation of obstacles and impediments standing in the way of a resumption of the sustained growth which, with differences of degree, characterized the evolution of the economies of the region during the three decades following the war. The mere fact that the export of commodities has ceased to be a source of dynamic impulses promoting growth, and that the region has become a net exporter of financial resources, makes it clear that any recovery must be based on measures different from those of the past. Furthermore, the changes and setbacks that have affected the economies of the region in recent years have even changed their manner of functioning compared with the situation that prevailed in the early 1980s.

Thus, during the crisis the trends of the sectoral structure of production and employment were reversed, as was the relation between production and external trade. The industrial sector, which was already losing its role as the engine of economic growth in many countries even as far back as the second half of the 1970s, saw its relative share of the national product go down between 1980 and 1986, and in quite a few cases there was even a fall in the absolute value of the industrial product, giving rise to a process of de-industrialization.<sup>12/</sup> In contrast, the relative share of the agricultural sector increased as a result of its having maintained an annual growth rate of approximately 2.5%, which, while lower than its growth rate during the 1970s, was notable in comparison with the declining growth rates in other sectors.

The magnitude of the change can be seen from an analysis of the available figures on the level and structure of employment. Between 1980 and 1985, total employment did not fall as much as the level of economic activity, so that there was a change in the historical product/employment ratios. This was achieved by down-grading employment in the sense of reducing productivity. Thus, employment in the manufacturing sector went down in relative terms compared with total employment, and in some countries it even fell in absolute terms. In contrast, in the services sector, including informal activities, employment rose by up to 20% in a number of countries during the 1980-1985 period, but this was accompanied by substantial declines in productivity.

Significant structural changes also occurred in the external sector of the economies, which are reflected in changes in the import and export coefficients, in keeping with the reduced level of domestic consumption and of investment, as well as of those activities that require more imported inputs. This new form of functioning has been promoted, at the same time, by substantial changes in relative prices. Devaluations and restrictive domestic expenditure policies have brought about new price relations which favour tradeable goods to the detriment of non-tradeable goods, and also contribute to a high real interest rate and to lower real wages and salaries. The main point, however, as already noted, is that a region which historically mobilized external savings in amounts equivalent to around 2% of its gross

domestic product has been abruptly transformed into a net exporter of financial resources.

## II. THE PROSPECTS FOR THE PERIOD 1988-1992

### 1. General considerations

At first sight, it seems likely that the same external factors which prevented sustained growth during most of the present decade will continue to exist and may even worsen during the remainder of the present decade and beyond. In the first place, the widespread uncertainty that has characterized the international economy is now made worse by the probability of a period of very slow growth in the major industrialized economies of the world --with even a risk of a recession-- as a consequence of the macroeconomic imbalances in most of those economies, in combination with the impact on international economic relations that the form of response to those imbalances is likely to have.<sup>13/</sup> Secondly, even using the most optimistic scenario, all observers agree that commodity demand prospects, with few exceptions, are not at all encouraging.<sup>14/</sup> Of particular relative importance in this regard is the evolution of the prices of hydrocarbons.

Thirdly, on account of the well known procyclical behaviour of private capital and the financial restrictions that affect the multilateral agencies, it is highly unlikely that the region as a whole will significantly expand its access to fresh capital resources, whether public or private; nor does it seem realistic to expect the repatriation of national capital to attain levels that would compensate for the expected decline in external financing. Finally, as the Secretariat has repeated in numerous documents, the problem of the external debt continues to be present, restricting the capacity to grow in the short term and the capacity to channel savings into investment with a view to future growth.

However, this latter obstacle is the one whose impact would be most capable of being modified during the next five years in comparison with the last five. As is well known, between 1980 and 1983 most of the countries in the region tended to subordinate the achievement of specific economic growth targets to the servicing of the external debt. As this practice led inexorably to tensions, an attempt was made to reconcile a minimally acceptable economic growth target with the continued servicing of the debt, by means of periodic restructuring and "forced" loans to finance a part of the interest payments due. This alleviated the tension, but did not change the fact that the transfer of resources was the principal obstacle standing in the way of achieving development targets.

Today, there is greater awareness of the need to reverse this process by subordinating the servicing of the debt to the attainment of development

targets, price stability and satisfaction of the basic needs of the population, converting the transfer of resources into a variable of the adjustment process instead of the main obstacle to growth. The objective of the prospective exercise which is described below is to explore the alternative scenarios facing the countries of the region. The results of this exercise confirm the previous analyses made by the Secretariat, which have highlighted the fact that the servicing of the external debt under the terms originally agreed upon in most countries constitutes a major obstacle not only to acceptable rates of growth but also to the achievement of levels of investment capable of bringing about the transformations in the productive sectors that would make it possible to achieve future growth on new bases.

Nevertheless, even if the transfer of financial resources abroad were halted by subordinating the servicing of the debt to other objectives, the development prospects for the vast majority of countries in the region --given the way their economies currently operate-- would still be rather bleak, reflecting the relative weight of the other restrictions described in the previous chapter. This highlights the fact that although the reversal of the trends of recent years as regards the servicing of the external debt is an indispensable condition for restoring the capacity for growth, it is by no means sufficient of itself.

## 2. Macroeconomic assumptions of the scenario

The current manner of functioning of the economy, briefly described earlier, limits economic growth significantly more than in periods before the crisis. In order to evaluate the current potential for growth, the question was therefore examined using assumptions that seek to incorporate and quantify the appraisals made on the macroeconomic level.

The exercise was prepared for the period 1988-1992, using an ECLAC numerical experimentation model <sup>15/</sup> based on the following assumptions. Firstly, with regard to the external setting, it was assumed that there will be annual growth of between 2% and 3% for the economies of the OECD countries as a whole, with an increase of 4% in world trade.

Secondly, it was assumed that real interest rates will remain high but will gradually decrease until in 1992 they reach a level two percentage points less than in the second half of 1987. In this regard, it should be recalled that countries have differing debt structures and different interest rates are applied to the various components of the debt. The weighted average for the majority of countries, based on the structure of their debt and the assumption of commercial interest rates, including commissions and other costs, will be between 7% and 9% in 1992. Thirdly, it was assumed that foreign trade prices--imports and exports-- will increase rather faster than in recent years (between 3% and 4%), although trade in hydrocarbons was excluded from this assumption in order to respect the considerable differences between countries. This is equivalent to assuming that the terms of trade index (excluding petroleum) will remain constant, even when the relationship between the nominal rate and the external trade price indexes appreciably influences the relative size of the debt.<sup>16/</sup>

Fourthly, with regard to the critical variable of the volume of exports, the underlying assumption was that this will not be increased at the cost of further reductions in domestic demand achieved, for example, by devaluations and the containment of real wages, and that the volume of commodity sales will not continue to be increased at the expense of prices, as happened in the period 1980-1986. Consequently, the greater part of the expansion in exports will have to come from the incorporation of new products. Thus, an increase of between 2.8% and 4.6% is projected in the volume of exports, depending on the country, which constitutes a relatively optimistic assumption in comparison with the world trade forecasts from the other sources mentioned above.

As already mentioned, separate hypotheses have been advanced for the volume and price of petroleum exports. With regard to the price, a value of US\$18 per barrel has been assumed for 1987, with increases of 5% in 1988 and 1989 and subsequent maintenance of the price until 1992, while it has been assumed that the growth rates for the volume of exports of the petroleum exporting countries will be between 2.5% and 3%.

Fifthly, the restrictions arising from external indebtedness have been dealt with in such a way as to ensure that both the debt/export ratio and the ratio between interest payments and the domestic product do not increase significantly. This condition has been applied more strictly in those countries where the first of these ratios is higher than 4 and the second higher than 0.05. The possibility of maintaining these values implies that if in a country the growth in export value permits higher net indebtedness, the latter will generally be achieved by way of forced loans or loans from official agencies.

Sixthly, as regards the internal functioning of the economies, it is assumed that the restrictions on domestic supply and the deterioration in the situation of many sectors will appreciably affect the demand for imports, which is closely linked to the growth of the national product in general and investments in particular. It is worth noting here that a good illustration of the internal limitations on supply is what happened in 1986 in the six countries which recorded annual growth rates of over 5%, since the volume of imports increased in all cases by more than 10%, and in three instances by more than 25%. The possibilities of controlling this increase are not the same in every case, although, as might be expected, those countries which have a more developed industrial structure have more chances of succeeding. In most of the countries, even where very high exchange rates prevail, there is a significant trend towards increased imports whenever there are signs of an economic recovery. Moreover, if other policy objectives lead to a reduction in the real rate of exchange, and imports are not controlled or selected by means of additional policy instruments, this effect becomes very marked, as was demonstrated in those countries where the rate of exchange was kept unchanged in the face of inflationary pressures.

Turning to the hypotheses based on more conservative assumptions, an increase in imports has been projected to simulate initially high but controlled growth, thus avoiding rates of three or more to one relative to the rate of increase of the product, such as have been witnessed in recent years. It has been assumed that in subsequent years, growth will be more in keeping with the long-term historical patterns. At the same time, the fact that only

moderate rates of growth of the product would be achieved suggests that domestic demand will not reduce the level of exports, as has occurred in more than one case in recent years when high rates of growth were attained.

On the other hand, it should be pointed out that in the attempts at reactivation that have been made so far, those countries which have achieved growth have had recourse to policy instruments which have promoted the simultaneous expansion of the income of the various social strata. In this regard, although there has been an increase in real wages and salaries and a decline in unemployment in those countries recording greater growth, the high-income groups have also enjoyed substantial increases in their incomes.<sup>17/</sup> The hypothesis of initially high but controlled growth of imports thus presupposes some degree of control over this phenomenon, although it does not call for significant changes in the general policy orientation. It should not be forgotten either that since 1982 many countries have reduced their stocks to minimum levels. Consequently, the processes of economic reactivation create additional demand over and above that needed for production in a given period, and this is reflected in an increase in levels of stocks, which in turn leads to pressure for increased imports.

### 3. The limits of economic growth

The methodology used to identify the possibilities of growth consisted of aggregating a set of macroeconomic restrictions --of both internal and external origin-- which could help to quantify the factors which limit economic growth. Thus, one or more of these constraints are determinants of the level of growth insofar as they are more limiting than the others.

Today the most severe external restriction facing the countries is the high level of indebtedness reached. The effort made by the countries of the region to pay at least a significant percentage of the interest due has had severe consequences on the balance of payments, and recently even on capital assets. Thus, many countries have striven to generate a trade surplus which has been used mainly to transfer financial resources abroad, while on the other hand, a number of countries have established mechanisms to convert the promissory notes on their debt into shares in national assets.

The higher the relative levels of indebtedness, the greater the pressures are, or, viewed from another angle, the greater are the efforts required in terms of the trade surplus or the conversion of promissory notes in order to cover at least part of the burden of interest payments. For those countries which have high levels of indebtedness and which do not succeed in generating significant trade surpluses, the debt constitutes the first constraint on growth. In such a situation, it is only possible to increase imports by small percentages and there are enormous difficulties standing in the way of the financing of investment through the transfer of savings. In such cases, growth of the product is restricted to the very small amount permitted by an increase in the value of exports or the transfer abroad of the ownership of national assets.

For those countries whose indebtedness is not at the highest levels and which enjoy trade surpluses, the external restriction on growth is imposed by

the extent to which they are able to reduce their trade surplus and bring new real resources for growth. Those countries which unilaterally adopt decisions to condition the payment of their debt to their economic growth may also be included in this category. In these cases, countries generally choose to increase their imports by a larger amount than would be possible if they had to rely on a rise in the value of their exports or on other short-term mechanisms such as drawing down their reserves. In any case, it is clear that although the banks may be willing to increase their forced loans (capitalization of interest) to some extent, it would be unrealistic to expect them to increase their voluntary loans. The maximum limit of imports would therefore be largely determined by the elimination of the trade surplus. This limit on growth is significant since it also serves to evaluate, in the medium term and with the current manner of functioning of the economies, the growth which could be achieved by those countries that opt for unilateral moratoriums.

For those debtor countries which show a trade deficit, the external restriction is of another kind and constitutes a third type of limitation on growth. The majority of Latin American countries have little access to voluntary loans, except in a few cases (especially those of certain nations of very small economic size) where the countries have had greater access to sources of official multilateral, and especially bilateral financing. This latter type of financing sometimes includes a non-economic component. For each country, the prospective studies have adopted assumptions concerning the scale which this type of financing could attain. Naturally, as the possibility of financing the deficit shrinks it would be necessary to restrict imports, with the consequent negative impact on growth.

In the three cases of external restrictions that have been considered, the starting point was an estimate of the growth in the volume of exports and an assumption as regards the likely evolution of the prices of exports and imports. If the estimate of the volume or of prices were to be modified, while still remaining within the framework of the prospective studies mentioned above, the balance of payments problem would change in terms of its extent, but not in terms of its basic nature.

There are constraints of a domestic nature which, under certain circumstances, may equal or even surpass in gravity those of an external nature referred to above. The first of these, which is applicable at least to the year 1988, concerns those countries in which the rate of inflation has exceeded 100%. All the indications are that in some countries the need to reduce inflation in adverse external circumstances will make it necessary to limit growth more than would be dictated by the external restrictions alone.

A second restriction is determined by the capacity of the economic policy to establish an interest rate capable of sustaining productive investment. This is not easy to achieve in view of the fact that formal and informal financial mechanisms have been established which facilitate the transfer of savings abroad. Governments may therefore have to face severe pressures on the exchange rate if they try to maintain interest rates that promote greater domestic activity and investment.

The other domestic constraints, including the limit on the growth of investment, have been defined as a function of the sociopolitical possibility of expanding the margins of manoeuvre both domestically and regionally. Thus, if the composition of demand were to be modified, selective foreign trade policies established and regional trade expanded, the restrictions on imports could be significantly altered. On the other hand, the possibility of checking inflation or increasing domestic savings and consequently eliminating the obvious restrictions inherent in the limited percentages of the product available for investment depend, in democratic systems, on the achievement of a political agreement that expands the margin of manoeuvre of governments.

The same may be said of the region's negotiating capacity, the strengthening of which could, at least partially, ease the external restrictions described above. In other words, it is a question of the extent to which a restriction may be eased in order to increase the domestic room for manoeuvre as a manner of facing up to the current external situation, and even modifying it to some degree. For some countries this restriction is as severe a constraint as the external ones, and in many respects these two types of restrictions reinforce each other.

#### 4. Results of the exercise

Examination of the results highlights the difficulty faced by the countries today in achieving moderate growth rates in the medium term with a reasonable degree of continuity. At the same time, it can be seen that the set of obstacles which have to be surmounted affect the individual countries of the region in very different ways.

A first group of countries consists of those which have managed in recent years to generate and maintain a trade surplus. In most cases, these are the large and medium-sized countries of the region. At the same time, they are the countries which concentrate among them a high percentage of the Latin American external debt.

The three countries which are biggest from the economic and demographic point of view obviously form the group whose degree of fulfillment of their debt servicing commitments most affects the international financial system. In the last few years, they have achieved a surplus on their external trade in goods which has amounted on occasions to 50% of their total exports of goods, so that they have managed to cover high percentages of their interest payment commitments. On the other hand, their degrees of relative indebtedness are very high, representing between 4 and 6 times the total value of their exports. Over the last three years, tensions have grown up between these countries and the creditor banks, since because of the countries' efforts to grow or on account of abrupt falls in their export prices, it has become difficult for them to keep up such trade surpluses.

The effects of this conflict have been clearly brought out in the projection exercises. Thus, if the restrictive factor represented by maintenance of the present relative levels of indebtedness is applied, these countries could attain an annual average growth rate of 3.7% in the next five years (see table 1). If, on the other hand, they were allowed to bring their

Table 1

**LATIN AMERICA AND THE CARIBBEAN: PROJECTION OF SELECTED  
MACROECONOMIC VARIABLES ACCORDING TO DIFFERENT SCENARIOS, 1992**

	Annual growth rate of GDP (percentage) 1988-1992	Trade balance as a percentage of exports	External debt	
			Billions of of dollars	As a percentage of exports
<b>Maintenance of external debt/exports ratio at 1986 level</b>				
Latin America and the Caribbean	2.9	10.1	540	394
Large countries <sup>a</sup>	3.7	11.8	361	434
Medium-sized countries <sup>b</sup>	0.2	10.5	114	319
Small South American countries <sup>c</sup>	0.9	10.6	32	377
Small Central American and Caribbean countries <sup>d</sup>	0.8	-5.6	33	348
<b>Trade balance in equilibrium</b>				
Latin America and the Caribbean	4.2	0	594	435
Large countries <sup>a</sup>	4.9	-	406	488
Medium-sized countries <sup>b</sup>	1.8	-	130	362
Small South American countries <sup>c</sup>	2.1	-	36	426
Small Central American and Caribbean countries <sup>d</sup>	1.5	-	22	247
<b>Partial easing of external obstacles</b>				
Latin America and the Caribbean	4.1	0.3	600	437
Large countries <sup>a</sup>	4.4	5.6	384	462
Medium-sized countries <sup>b</sup>	2.8	-5.5	141	390
Small South American countries <sup>c</sup>	2.9	-5.4	37	442
Small Central American and Caribbean countries <sup>d</sup>	3.1	-20.5	38	397

Source: ECLAC, on the basis of official data.

<sup>a</sup> Argentina, Brazil and Mexico    <sup>b</sup> Chile, Colombia, Peru and Venezuela    <sup>c</sup> Bolivia, Ecuador, Paraguay and Uruguay.

<sup>d</sup> Costa Rica, Dominican Republic, El Salvador, Guatemala, Haiti, Honduras and Nicaragua.

trade balance down to equilibrium level, which would involve an expansion in forced loans and an increase in their imports, these growth rates could rise to 4.9%. A scenario was developed --and will be used as the mid- or focal point in the analysis of the results-- which consists of a partial easing of the external constraints on growth within the limits of the best agreements reached by the countries in their external negotiations. In the case of the large countries, this meant applying the ceiling values of 1986 to two of them, while for the third country the trade balance was used as a limit, because this country's present level of exports was based on a broader productive structure, its exchange rate is at a more normal level, and its interest commitments represent a smaller percentage of the product. According to this scenario, the annual growth rate of the group would be 4.4%. At all events, for the first two countries this scenario involves a relative reduction in the present trade surplus, since if the present level were maintained the growth rate would be lower.

The situation of the medium-sized countries is different from that of the first group, in that their present trade surplus is substantially less in comparison with their exports --and even became a deficit in 1987 in one of them-- and the average level of indebtedness is also relatively lower. As a result, in all cases the margin for expansion represented by the use of part of the present trade surplus for increased imports is limited, and in the case of a deficit on the trade balance, the opposite effect would take place.

Moreover, taking into account the lower degree of development of the productive structures of these countries compared with the large nations, they are more sensitive to variations in external trade and are particularly sensitive to factors affecting the use of imported intermediate inputs needed to maintain their level of activity. The internal constraints already referred to likewise play a more important role in some of these countries, so that their growth possibilities are also more limited. Strict application of the present levels of indebtedness as a growth constraint would permit an average annual growth rate in 1988-1992 of only 0.2%, and although with balanced external trade this figure would increase somewhat, it would only rise to 1.8% (see table 1).

In establishing the scenario of partial easing of external obstacles, the growth constraint represented by the limit on indebtedness was lifted in the case of the two least indebted countries. In one of the countries, it was assumed that a trade deficit with respect to exports similar to that registered in 1986 could be maintained, and in the other country --where a policy of changing debt promissory notes into national equity securities is being applied-- it was assumed that this mechanism would continue to function within limits similar to those currently prevailing. In this way, the annual average growth rate of the group would amount to around 3%.

The most dramatic situation is that of the small countries, whose economies, in most cases, are now functioning with a trade deficit. They are the countries which are most sensitive and vulnerable to external trade factors, and in the case of the Central American countries, they also have to face the economic effects of the political conflicts in that subregion. Maintenance of the present levels of indebtedness would require the generation of a trade surplus, for which purpose it would be necessary to

reduce imports, with consequent stagnation or recession in most of these nations. An attempt to achieve a balanced trade situation would have similar, although not quite so serious, effects. Thus, in establishing the scenario of partial easing of the external obstacles used in this study, it was assumed that in most cases the present levels of trade deficit would be maintained, which implies a need for the granting of fairly substantial official credits or transfers. If this were done, these countries too could reach an average growth rate of around 3% (see table 1). This would be a scenario reflecting a relatively optimistic exploration of the growth possibilities available by basically maintaining the parameters within which the countries of the region are functioning at present.

If the results in question are analysed in terms of per capita income, the picture is a discouraging one. Whatever the scenarios used for the 18 countries studied, in 1992 twelve of them would have a per capita product lower than that of 1980, one of them would maintain the same level as in that year, and only five would rise above it. The two countries which had already exceeded their 1980 per capita product in 1986 would be the only ones that would have clearly superior levels in 1992, although even then the increase would be very modest for a period of twelve years (equivalent to average rates of 1% and 1.6% per year).

Attaining these rates would, in its turn, involve an increase in the average import and investment coefficients (see table 2). The ratio between imports and the product would rise to higher values than those of 1986, but in most cases these would continue to be substantially lower than the 1980 levels. The situation would be rather similar with regard to investment coefficients, but in some countries the growth with respect to 1986 would be very small because of the restrictions already referred to. If growth is slow and the investment coefficients are relatively low, it will not be possible for most of the countries of the region to make up for their growing lag behind the developed economies. This is particularly so in the case of the medium-sized and small countries, where the investment coefficients stand at very low levels (see table 2).

In order to illustrate the significance of this scenario, the results have also been explored in terms of the sectoral structure of production, employment and productivity.

During the crisis, there was not only an alteration in the sectoral structure of the product but also a significant change in the sectoral structure of employment and productivity. The share of the industrial sector in the product went down by nearly two percentage points in the course of the period 1980-1985.<sup>18/</sup> At the same time, the share of industrial employment in the total went down substantially, suffering an average drop of around two and one-half percentage points, although there were cases where the reduction was double this figure (see tables 3 and 4). In contrast, the increase in the share of employment of the services sector was very high, and since to a large extent this employment was in activities of very low productivity, the value of the latter variable dropped rapidly in the sector.

Table 2

**LATIN AMERICA AND THE CARIBBEAN: PER CAPITA GROSS  
DOMESTIC PRODUCT, INVESTMENT, IMPORTS  
AND EXPORTS, 1986-1992**

	Per capita product 1980 =100;		As percentages of gross domestic product					
			Investment		Imports		Exports	
	1986	1992	1986	1992	1986	1992	1986	1992
<b>Maintenance of external debt/exports ratio at 1986 level</b>								
Latin America and the Caribbean	95	99	16.0	18.6	10.4	11.5	14.4	15.0
Large countries <sup>a</sup>	96	105	15.9	19.2	7.0	8.5	11.9	12.1
Medium-sized countries <sup>c</sup>	92	84	16.0	16.7	20.2	23.0	21.5	25.4
Small South American countries <sup>d</sup>	89	79	15.5	15.5	22.6	24.4	23.9	27.3
Small Central American and Caribbean countries <sup>a</sup>	88	81	18.1	17.4	25.8	26.5	23.9	28.5
<b>Trade balance in equilibrium</b>								
Latin America and the Caribbean <sup>e</sup>	95	106	16.0	20.2	10.4	12.0	14.4	14.1
Large countries <sup>c</sup>	96	111	15.9	21.1	7.0	8.8	11.9	11.4
Medium-sized countries <sup>b</sup>	92	91	16.0	17.5	20.2	23.4	21.5	23.3
Small South American countries <sup>d</sup>	89	84	15.5	14.1	22.6	25.8	23.9	25.7
Small Central American and Caribbean countries <sup>a,e</sup>	90	86	17.1	16.8	24.5	25.1	25.1	28.8
<b>Partial easing of external obstacles</b>								
Latin America and the Caribbean	95	105	16.0	19.7	10.4	12.0	14.4	14.2
Large countries <sup>c</sup>	96	109	15.9	20.5	7.0	8.4	11.9	11.7
Medium-sized countries <sup>f</sup>	92	96	16.0	17.4	20.2	23.7	21.5	22.2
Small South American countries <sup>d</sup>	89	88	15.5	17.8	22.6	26.0	23.9	24.7
Small Central American and Caribbean countries <sup>a</sup>	88	90	18.1	18.1	25.8	27.0	23.9	25.4

Source: ECLAC, on the basis of official data.

<sup>a</sup> Argentina, Brazil and Mexico.

<sup>b</sup> Chile, Colombia, Peru and Venezuela.

<sup>c</sup> Bolivia, Ecuador, Paraguay and Uruguay.

<sup>d</sup> Costa Rica, Dominican Republic, El Salvador, Guatemala, Haiti, Honduras and Nicaragua.

<sup>e</sup> Excluding Nicaragua.

Table 3

**LATIN AMERICA (FIVE COUNTRIES)<sup>a</sup>: STRUCTURE OF  
GROSS DOMESTIC PRODUCT AND OF EMPLOYMENT,  
AND INDEXES OF PRODUCTIVITY**

(Percentages)

Sector	1980	1985	1992
	Historical		Projections
	<b>Gross domestic product</b>		
<b>Agriculture</b>	11.0	12.2	11.6
<b>Manufacturing</b>	25.4	23.8	24.4
<b>Other activities</b>	63.6	64.0	64.0
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
	<b>Employment</b>		
<b>Agriculture</b>	29.0	28.9	25.4
<b>Manufacturing</b>	19.9	17.6	16.0
<b>Other activities</b>	51.1	53.4	58.6
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
	<b>Product per person employed</b>		
<b>Agriculture</b>	37.9	42.2	45.7
<b>Manufacturing</b>	127.6	135.2	152.5
<b>Other activities</b>	124.5	119.9	109.2
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

Source: 1980: census data; 1985: preliminary figures on the basis of data from national surveys and from the document of the Regional Employment Programme for Latin America and the Caribbean (PREALC), *Avance y agenda social. un enfoque estructural*, Santiago, Chile, PREALC, 1987; 1992: ECLAC projections.

<sup>a</sup> Argentina, Brazil, Mexico, Colombia and Peru.

Table 4

**LATIN AMERICA (THREE COUNTRIES)<sup>a</sup>: STRUCTURE OF  
GROSS DOMESTIC PRODUCT AND OF EMPLOYMENT,  
AND INDEXES OF PRODUCTIVITY**

(Percentages)

Sector	1980	1985	1992
	Historical		Projections
	<b>Gross domestic product</b>		
Agriculture	6.5	7.8	7.5
Manufacturing <sup>b</sup>	42.2	41.0	41.3
Other activities	51.4	51.2	51.2
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
	<b>Employment</b>		
Agriculture	17.1	16.8	14.3
Manufacturing <sup>b</sup>	29.1	24.9	21.4
Other activities	53.8	58.3	64.3
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
	<b>Product per person employed</b>		
Agriculture	58.1	46.4	52.4
Manufacturing <sup>b</sup>	145.7	164.7	193.0
Other activities	95.0	87.8	79.6
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

Source: 1980: census data; 1985: preliminary figures on the basis of data from national surveys and from the document of the Regional Employment Programme for Latin America and the Caribbean (PREALC), *Apoyo y deuda social: un enfoque estructural*, Santiago, Chile, PREALC, 1987; 1992: ECLAC projections.

<sup>a</sup>Chile, Costa Rica and Venezuela. <sup>b</sup>Covers the non-agricultural goods-producing sectors.

In the exercises, it was assumed that the level of open unemployment registered in 1985 would not increase, since although the growth rate contemplated in the scenario is low, low-productivity jobs are being created in the countries to cope with unemployment. In these circumstances, it may be expected that even if growth is not sufficient to absorb the labour supply in high-productivity jobs, the employment trends of the crisis period will be maintained, although in a somewhat reduced form, since the assumed growth rate, modest though it is, will bring with it increases in industrial productivity which will lead to a further reduction in the share of industry in total employment in most of the countries.

The surplus labour will be employed in the services sector, so that this sector's share in the employment structure will amount in some countries to more than 60% of the total. Even in countries which do not reach this percentage, there will be an increase of over three percentage points in the share of the services sector in employment during the period 1987-1992, with very few countries escaping from this trend. The consequences of these phenomena for the ratios between sectoral productivity levels are very considerable, since the average productivity of services will go down significantly compared with the average productivity of the economy as a whole. This means a strong challenge with regard to income distribution, which will tend to deteriorate. The result of this would be the development of increasingly inequitable societies where the proportion of persons working in high-productivity sectors would go down and the gulf between them and the great masses of the population would increase (see tables 3 and 4).

The influence of the external factors which act as impediments to economic growth is so great that it is essential to examine the possible effects of variations in the basic assumptions adopted with regard to the external setting.

In accordance with this line of thought, a first set of projections was devoted to analysing the effect of a drop in interest rates (see table 5). Mention has already been made of the very varied composition of the debt in the different countries of the region. Consequently, in assuming a reduction of two percentage points in the interest rate on the total debt, it was assumed that the reduction in the rate on loans by the transnational banking system could be greater in cases where the interest rate on the remaining loan remain unchanged: a very reasonable assumption in the case of official credits granted at low fixed interest rates. As might be expected, the effect of a reduction such as that referred to on economic growth would be uneven, depending on the individual countries, and would be of greater benefit to those countries where the main obstacle to growth is the level of indebtedness. For the region as a whole, such a drop in interest rates would enable the growth rate to rise by nearly 1% per year. It would therefore have an important effect, especially for the countries at present suffering most severely as a result of their high level of external indebtedness. In some of these countries, the effect on the annual growth rate would exceed 1.5 percentage points (see table 5).

A second set of projections examined the effect of a drop of two percentage points in the annual growth rate of the volume of exports, which would bring this volume to a level closer to the figures mentioned in some

Table 5

**LATIN AMERICA AND THE CARIBBEAN: PROJECTION OF SELECTED  
MACROECONOMIC VARIABLES ACCORDING TO SCENARIOS BASED  
ON VARIATIONS IN BASIC ASSUMPTIONS REGARDING  
THE EXTERNAL CONTEXT, 1992**

	Annual growth rate of GDP		Trade balance, as a percentage of exports		External debt	
	1988	1992	percentage	percentage	Billions of dollars	As a percentage of exports
<b>Reduction in interest rates, with debt/exports ratio same as that of "partial easing of external obstacles" scenario<sup>a</sup></b>						
Latin America and the Caribbean	5.0		-8.8		599	437
Large countries <sup>b</sup>	5.4		-4.5		384	462
Medium-sized countries <sup>c</sup>	3.7		-12.8		140	390
Small South American countries <sup>d</sup>	3.8		-14.5		37	442
Small Central American and Caribbean countries <sup>e</sup>	4.9		-27.0		38	397
<b>Reduction in growth rate of volume of exports, with debt/exports ratio same as that of "partial easing of external obstacles" scenario</b>						
Latin America and the Caribbean	2.1		8.0		545	437
Large countries <sup>b</sup>	2.5		14.4		348	462
Medium-sized countries <sup>c</sup>	0.9		-		128	390
Small South American countries <sup>d</sup>	0.9		2.9		34	442
Small Central American and Caribbean countries <sup>e</sup>	-0.2		-12.5		35	397
<b>Recovery of 1988 commodity prices<sup>f</sup> to 1981 levels, with debt/exports ratio same as that of "partial easing of external obstacles" scenario</b>						
Latin America and the Caribbean	4.7		-1.3		606	426
Large countries <sup>b</sup>	5.1		3.9		385	446
Medium-size countries <sup>c</sup>	3.1		-7.9		147	395
Small South American countries <sup>d</sup>	3.9		-9.5		38	436
Small Central American and Caribbean countries <sup>e</sup>	2.9		-14.7		36	361

Source: ECLAC, on the basis of official data.

<sup>a</sup> See table 1. <sup>b</sup> Argentina, Brazil and Mexico. <sup>c</sup> Chile, Colombia, Peru and Venezuela. <sup>d</sup> Bolivia, Ecuador, Paraguay and Uruguay. <sup>e</sup> Costa Rica, Dominican Republic, El Salvador, Guatemala, Haiti, Honduras and Nicaragua. <sup>f</sup> Excluding petroleum.

prospective studies prepared in the developed countries (see table 5). It may be recalled that in the scenario under consideration a relatively optimistic hypothesis was used in this respect. In this case, the effects operate in the opposite direction and are greater than those generated by a fall in interest rates. Thus, in these circumstances, the growth of the region as a whole would drop by two percentage points to an average annual level of only 2%. The repercussions would be particularly serious for the Central American and Caribbean countries, whose growth rates would drop by three percentage points, thus leading to virtual stagnation.

Finally, the consequences of a change in commodity prices (excluding petroleum) were studied. In this connection, it should be noted that petroleum represents a substantial percentage of Latin America's exports and imports, amounting in the period 1980-1985 to nearly 40% and 20% of the respective totals. With regard to the remaining commodities, these are goods which are also imported to a lesser extent by countries of the region, so that it is generally necessary to take account of both effects. In the prospective exercises, the prices were set at the 1981 levels. The effects of this option are not very important for countries such as Ecuador, Mexico and Venezuela, where the proportion of commodity exports accounted for by petroleum is very high. In contrast, however, in those countries where there has been a substantial fall in export prices, such as Argentina and the Dominican Republic, significant increases in the foreign exchange income would be achieved under this assumption. Thus, it was calculated that the increase in the growth rate that could be achieved if the 1981 prices for such commodities were restored would be between zero and two percentage points.

The results of the scenario assuming a partial easing of the external obstacles show that the present form of functioning of the economy places very severe obstacles in the way of growth and gives grounds for expecting a deterioration in the socioeconomic situation.

It is therefore essential to eliminate these obstacles, at least to some extent, and it is consequently necessary to explore a scenario which involves changes in the present forms of functioning of the economy and in the set of parameters forming the external context in which the region operates.

This alternative scenario of change must have some features that can be deduced from the above-mentioned results. First of all, it is necessary to consolidate the possibility of eliminating the present limits fixed on external indebtedness so that the countries with trade surpluses can use them to increase their imports and thus resume their position as absorbers of real resources. This would put an end to the transfer of financial resources to the exterior. In the present situation of Latin America, this change would make it possible --in the case of the large countries-- to increase growth rates to an average of 5% per year. Moreover, the total amounts needed to permit an increase in the present deficit of the small countries would be relatively small, taken in a global context, yet would allow these countries to increase their growth rates to levels around 4% (above which other factors of an internal nature would stand in the way of growth). In the following sections, alternative solutions are explored with regard to the easing of the debt situation and the strengthening of regional bargaining power that would make it possible to reduce the external constraints.

Secondly, if it is accepted that the external trade prospects are particularly negative with respect to the export of primary commodities and others which are more exposed to a deterioration in the terms of trade, then it is necessary to change the nature and composition of external trade. In this respect, it is obvious that it will be impossible to take part in the most dynamic lines of world trade without a thorough-going transformation of the productive mechanism. This raises the dilemma of how to make an investment effort at a time of financial constraints and limitations on imports. Putting off the effort, however, will mean that in a few years' time the conditions will be still worse. Consequently, the selective management of external and internal resources, which is impossible without compressing the consumption of the higher income groups, is a change which is unavoidable if it is desired to carry through this transformation, the fruits of which will in any event only be harvested in the medium term. In the following sections, an analysis is made of the desirable characteristics of a transformation of the productive mechanism, less inequitable growth policies, and regional co-operation measures which illustrate these aspects of the alternative scenario.

Thirdly, the trade and financial links with the exterior must be arranged in such a way that the economies can to a substantial extent divorce themselves from the vicissitudes of the international economy and from the effects of such key variables as interest rates and exchange parities. If it is not possible to avoid these phenomena, this makes medium- and long-term economic calculations more difficult and places serious obstacles in the way of channeling domestic saving into productive investments, since domestic activities are competing with a financial system which offers very high real interest rates and also enjoys public guarantees and tax exemptions.

Finally, in defining the policies a central role must be played by the search for greater equity. The scenario under consideration calls for appreciable sacrifices and needs political support in order to improve governability. It is essential to restructure both public and private domestic expenditure in favour of the groups most seriously affected by the crisis, both for political and economic reasons. For political reasons, because those who have suffered most from the impact of the crisis will only be willing to support an option which from its very beginning points towards more equitable sharing of the costs, which is an indispensable requisite for the functioning of democracy. For economic reasons, because the strengthening of national and regional markets as a complement to and support for a competitive form of insertion in the external economy in the long term must be considered a priority task, since the region cannot continue to put off taking decisions in this respect while awaiting more favourable evolution of the external setting.

The alternative scenario of change would thus have the following characteristics. It would achieve a higher but moderate growth rate which would be around 5% in the first five-year stage. The expansion of investment would bring with it a change in the structure of employment, once again strengthening and extending the branches of highest productivity. Thus, increasing the income of the great masses would be achieved in the medium and long term through employment, and in the short term, by restructuring both public and private domestic expenditure. On the other hand, it would be essential for an appreciable part of the income of the more favoured groups to be channeled into saving and investment, while at the same time limiting

consumption. The national and regional markets would play a complementary role to that of the external markets, thus recovering at least in part a structure more appropriate to large-scale production, instead of a wide range of imports designed to give greater flexibility to supply, as is demanded in the consumption of small groups.

### III. THE REQUISITES FOR ACHIEVING DEVELOPMENT

#### A. GENERAL CONSIDERATIONS

##### 1. Constraints and potential

Some of the factors that have prevented the vast majority of the region's countries from achieving sustained growth were explored in the foregoing chapters, and the conclusion was reached that these factors will persist in the foreseeable future. This means that the painful effects of the crisis, of a magnitude and scope inconceivable only a few years ago, can be expected to continue and, in some cases, even grow worse. The final result of this will be not only to eliminate some of the considerable economic and social progress achieved by the region in earlier decades, but also to endanger the consolidation and extension of political processes leading to pluralistic and participative democratic systems.

Neither the governments nor the societies can view this panorama with indifference. The region has major assets --including the size of its market if taken as a whole, its human and natural resources and its creative capacity-- that must be exploited in order to help reverse the way the crisis is evolving and face the twenty-first century with a systematic and concerted effort to develop, marked by renewed vigour and determination. Beyond any doubt, Latin America and the Caribbean already showed, during the thirty years following the war, their capacity for change and growth in spite of the shortcomings already referred to in other parts of this document.

For expanding its room for manoeuvre in the field of economic policy, the region also has another important asset which is at present very under-utilized: intra-regional co-operation and, in particular, the subregional integration processes. Now more than ever, those processes could be a powerful influence in surmounting the main restrictions on development. This topic is therefore taken up again later in this document in order to explore ways of taking fuller advantage of the region's extensive potential.

Mobilizing these assets in the face of the mass of restrictions referred to in the previous chapters does, however, call for a certain number of requisites. The most urgent of these --at least for many of the region's countries-- consists in expanding the extremely narrow room for manoeuvre in the field of economic policy imposed by the external restrictions, particularly as regards financing the future expansion of productive capacity. This greater freedom of action should be used to promote consistent and

lasting economic and social changes which will ensure vigorous and equitable growth in the future.

The present chapter therefore explores first of all the options available for subordinating the servicing of the external debt to the fulfillment of minimum targets of national development. This would increase the amount of foreign exchange available for financing the necessary changes and reaching the minimum goals of economic expansion.

Next, some general guidelines on the type of changes that are needed to achieve medium- and long-term development are discussed, recognizing that each country has its own special features. In this respect, not only is the issue of how to progress towards a productive structure offering potential for greater and more sustained growth discussed, but also the question of how to move towards growth characterized by equity. These topics are dealt with in three sections.

Firstly, the transformation and modernization of the region's productive structure are examined, with emphasis on the need to alter the export structure and increase the capacity to produce import substitutes with reasonable efficiency. Of course, this does not mean that it is any less important to keep on insisting on a system of international trade which is more transparent and which discriminates less against goods and services from the region,<sup>19/</sup> but the countries of Latin America and the Caribbean cannot hope to return to the path of sustained and environmentally sound growth unless they make substantial changes in their structures of production.

Secondly, the topic of the need for equity is discussed. This need is due both to ethical considerations --the material well-being of broad strata of the Latin American population is at such a level that it cannot bear any further deterioration-- and to economic and political considerations, in view of the vital need to preserve and consolidate the region's democratic systems.

Thirdly, an analysis is made of the existing basic macroeconomic imbalances which, if allowed to continue, would make it difficult to resume the path of economic growth: beyond any doubt, adjustment and the control of inflation, within the framework of more equitable systems, are essential requisites for returning to development.

Finally, there is the question of the agents which are to be responsible for stimulating and implementing the changes proposed. In this sense, the tendency towards democratic and pluralistic systems, quite apart from its intrinsic value as a development target, can be vitally important in paving the way for broad national agreement which unites the different sectors of society around a national development project.<sup>20/</sup> All the countries which have succeeded in the intensive and lasting promotion of a form of development based on broad technical and productive modernization possess a great capacity for organized collective action. Whatever the ideology followed, this type of development is impossible without a high level of organization of society as a whole.

The countries of the region have been seeking to achieve such a capacity. However, for various reasons, some of them deeply ingrained in the social

structure, this effort has proved fruitless or has not been capable of continuing its course for long. The decisive fact to be underlined here is that, as in other aspects, the crisis has helped to weaken that capacity for organized collective action and in many cases has undone the efforts undertaken during several decades. Thus, for example, in many countries the conflicts of interests among social groups have been aggravated. These conflicts naturally help to weaken the mechanisms which link the economic agents with each other and which are vital to the capacity for organized collective action.

Furthermore, this capacity is also weakened by the decline in "governability" or the capacity of governments to formulate and execute their development policies. There are many factors which contribute to this decline such as: institutional structures which prevent the State apparatus from undertaking co-ordinated action; the increasing demands of society on the government and the deepening political conflicts in situations where the party systems are unable to perform their role of linking and integrating interests; and the influence of external factors which weaken the fiscal capacity and, because of their considerable volatility, prevent the maintenance of a stable economic development policy.

The experience of recent years highlights the fact that the capacity for organized collective action should not be underestimated: this is a *sine qua non* for the success of a stable and equitable development policy. The trend towards its weakening must therefore be reversed through long-term action by the social agents and the governments aimed at building up institutional mechanisms linking the social agents with each other and with the government in order to ensure an ever-higher level of collective organization. This is a lengthy and arduous task, but one which would be greatly facilitated if the development policy laid special emphasis on the dimension of equity in order to reduce the social inequality and the conflicts which it brings in its train.

## 2. Some economic policy dilemmas raised by the transfer of resources to the exterior and basic macroeconomic imbalances

Before considering the requisites which must be fulfilled in order to reverse the recessionary trends of recent years, it is worth briefly examining some interactions among the constraints on development described in previous chapters, especially the transfer of financial resources to the exterior and basic macroeconomic imbalances.

The central fact which has conditioned the economic performance of many countries of Latin America and the Caribbean in the last five years has been, as already noted, the turnaround in the transfer of resources. In the 1970s, the region received net resources from the exterior equivalent to some 2% of the gross domestic product; between 1982 and 1987, in contrast, it has had to transfer to the exterior resources equivalent to an average of some 4% of the product. Even those countries which have not registered a negative transfer of resources (generally those of smaller economic size) have suffered a marked deterioration in the net mobilization of external saving.

Transferring resources to the exterior means effecting a domestic and external adjustment through policies affecting expenditure, the reassignment of resources, and conversion of resources into foreign exchange. Whatever the instruments chosen, the internal adjustment demands the reduction of expenditure with respect to the product: i.e., increasing domestic saving. However, as not all domestic savings are convertible into foreign exchange, there is also a problem of transformation, or external adjustment, in order to convert the resources saved into foreign exchange by reassigning domestic expenditure towards non-tradeable goods and services and reassigning resources to the production of tradeable goods.

The interrelationship between the transfer of resources and the problems of adjustment and inflation control can be illustrated in summary form by examining four economic policy dilemmas which are all interrelated with each other: raising the product or reducing expenditure; increasing exports or reducing imports; increasing saving or reducing investment; and raising taxation (including the so-called "inflation tax") or reducing public expenditure.

The first dilemma arises in connection with the external restrictions which exist in circumstances such as those which have characterized the evolution of many countries of the region in recent years. If the payment of interest on the external debt is kept up while at the same time the net inflow of capital goes down or disappears completely, then the sustained financing of the consequent transfer of resources will call for the generation of an equivalent trade surplus. This is where the first dilemma arises, since this surplus can be achieved by increasing exports, reducing imports, or a combination of both measures. For this purpose, it is necessary both to reduce the level or growth rate of expenditure and to reassign it from non-tradeable goods to tradeable goods.

As is well known, in the 1980s the countries of Latin America and the Caribbean have been obliged to make an extraordinarily rapid turnaround from a situation of trade deficits to one of trade surpluses. The very rapidity of this process has ruled out the possibility of increasing exports and compressing only non-essential imports. Instead, in view of the well-known rigidities standing in the way of diversifying and expanding exports and the fact that less than 15% of the region's imports are consumer goods (and even then, many of them are basic consumption items), it is not surprising that the bulk of the adjustment has been carried out by the compression rather than the substitution of imports of intermediate products and machinery, the volume of which has gone down by approximately 40%. This has given rise to a recessionary adjustment which has also prejudiced future growth.

This phenomenon raises a second dilemma which is closely linked with the restriction of overall expenditure. The above-mentioned turnaround in the transfer of resources has had as its inevitable counterpart a reduction in expenditure in relation to the product, rather than an increase in the product. This latter possibility has not materialized, in the majority of the countries, because the considerable external financing which was available up to 1981 was not used to raise productive capacity through new investments. Consequently, as from 1982 there has been a general reduction in expenditure in the region, with all its consequences of a recessionary nature.

Moreover, if it were sufficient simply to reduce and reassign expenditure in an amount equal to the required trade surplus, then the cost, although high, would have been bearable. The effort to reduce and reassign expenditure caused the product to fall, however, and this in turn made necessary an even greater cut in expenditure in order to achieve the trade surplus in question, since a reduction in total expenditure usually affects not only internationally tradeable goods, but also non-tradeable goods. This means that although an adjustment can indeed be achieved in this way, it involves a high cost in terms of a fall in economic activity and all its natural repercussions on political and social coexistence, since reducing the production of non-tradeable goods only permits the saving or generation of foreign exchange to the extent that tradeable inputs are used in such production.

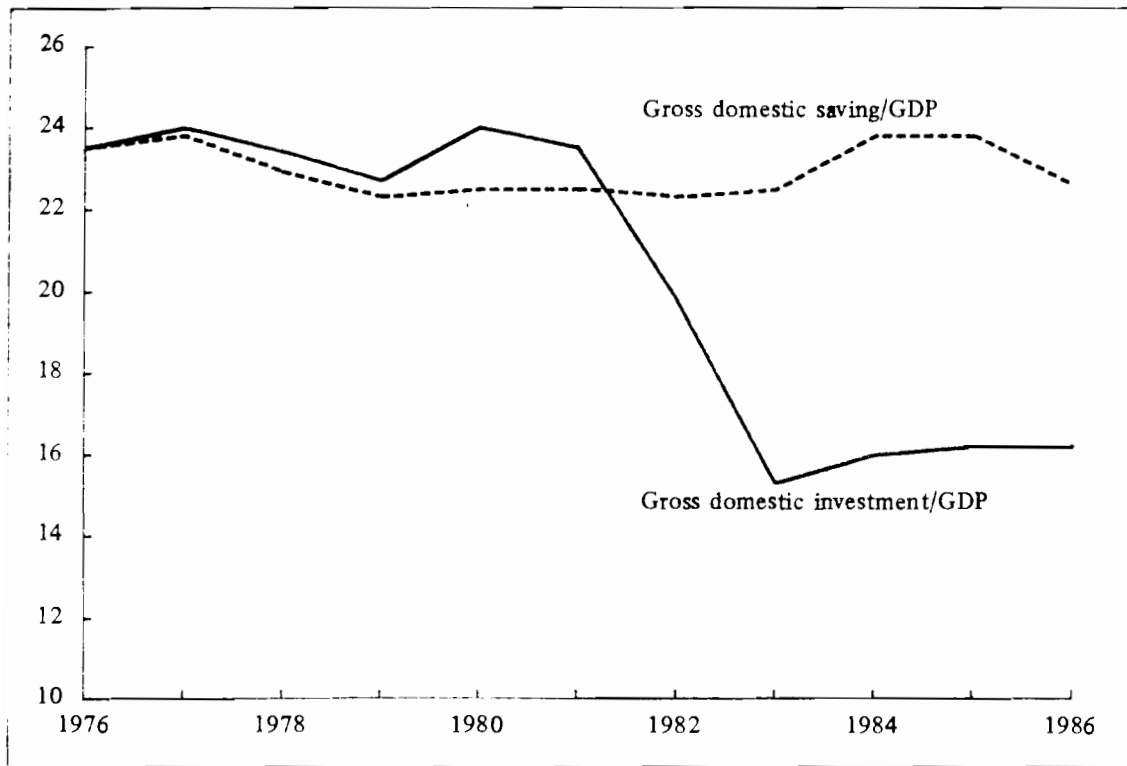
In principle, a drop in the product could be avoided if the resources freed by the reduction in the production of non-tradeable goods and services could be used immediately to expand the production of tradeable goods. In addition to the external demand constraints and other domestic constraints of a structural nature, however, the speeds of the two processes are very different: a reduction in domestic expenditure and in the production of non-tradeable goods can be as intensive and rapid as desired, but an increase in the production of tradeable goods, in contrast, requires time, since the resources freed in the non-tradeable goods sector have to be reassigned to the production of exportable goods and import substitutes. In other words, it is easier to reduce demand rapidly than to reorient production.

Increasing the trade surplus at a time when the product remains constant or even shrinks has a severe impact in the form of a reduction in consumption and/or investment, thus raising a third dilemma. Consequently, the only way of avoiding a still greater sacrifice of growth is to ensure that the reduction in expenditure needed in order to permit the transfer of resources to the exterior originates in greater domestic saving.

In order to appreciate the implications of this latter fact, it should be recalled that the transfer of resources to the exterior is equivalent to around one-fifth of domestic saving. Consequently, the turnaround in the transfer of resources from a positive figure to a negative one has not only meant that the adjustment has been recessionary, but also that almost the whole of it has been carried out at the cost of investment. Indeed, as noted in the previous chapter, in the majority of the countries investment has fallen by an amount equivalent to the turnaround in the transfer of resources (see figure 2). As external saving has gone down sharply with the crisis and domestic saving has had to be devoted largely to debt servicing, there have thus been much fewer resources available for investment.

A fourth dilemma is connected with the constraints on public finances. As is well known, most of the external debt is either public or State-guaranteed (70% before the crisis; over 80% at present). Consequently, it is the government which is responsible for making the bulk of the transfer of resources. Like any other agent, the government can mobilize these resources by reducing its expenditure, increasing its domestic indebtedness or raising its income. It can also resort to the issue of money. If the domestic capital markets are not very highly developed or have difficulty in absorbing

Figure 2

**LATIN AMERICA AND THE CARIBBEAN: COEFFICIENTS OF SAVING AND INVESTMENT***(As percentages of the gross domestic product)*

Source: ECLAC, on the basis of official data.

additional financing of the order of 4% of the gross domestic product, the financing must come from equivalent increases in income or reductions in expenditure; otherwise, it will have to come from money issue.

Since central government income or expenditure is only a small proportion of the product in most of the countries (10-20%), a turnaround in the transfer of resources equivalent to 4% of the product may mean that income has to be raised or expenditure reduced by much larger percentages (up to 40%). It is therefore not surprising that much of this transfer has been financed in the past through increased money issue. As the monetary base is also quite low in most of the countries of the region (5-10% of the product), money issue equivalent to only a few percentage points of this base can easily lead to an increase in inflationary pressures.

It should be noted that this phase of financing and mobilization of resources to the public sector is more difficult in countries where this sector normally suffers from a foreign exchange deficit, since the devaluation made necessary by the external adjustment aggravates the public deficit (expressed in national currency). Consequently, in order to avoid growing inflationary pressures, devaluations in such countries should be accompanied by extra efforts to control demand.

The effect of reducing the public deficit, for its part, depends on whether this is achieved by reducing public spending or by increasing income. If expenditure is reduced, then it is preferable that this reduction should be concentrated in consumption and, above all, consumption of tradeable goods. This usually raises a conflict, however, since the bulk of public expenditure (except that part of public investment made up of imported capital goods, and another important item which is that of armaments) is in non-tradeable goods. Consequently, this dilemma is difficult to solve: if the cut in public expenditure is concentrated on current expenditure there is a risk of a drop in production, since the saving of foreign exchange is only small; on the other hand, if the reduction is concentrated on tradeable goods, this means reducing investment, which not only affects the part made up of imported equipment, but often also the complementary construction works.

For these reasons, it would be preferable in principle to raise public income, since this usually has a greater incidence on demand for tradeable goods. For administrative and political reasons, however (with the important exceptions of the tax on energy products and the prices of other goods and services produced by State enterprises), most of the countries have not managed to secure a significant increase in public income during the period of the crisis, so that the effort to service the external debt has led mainly to a reduction of expenditure or an increase in money issue.

## B. GROWTH, SAVING AND DEBT SERVICING

### 1. Introduction

Reference has been made earlier in this document to the growing importance that the external debt has come to assume among the factors that have

restricted growth and investment in the 1980s. The nature and scope of the problem has been changing in the course of the decade along with the prevailing circumstances and the attitudes of the main agents --debtor governments, creditor banks, governments of creditor countries and multilateral organizations.<sup>21/</sup> However, over the entire period the asymmetrical nature of the burden created by the servicing of the debt has been evident, as has the persistence of the problem, which has restricted the short-term capacity for growth and the capacity for investing in a new productive base in order to restructure the economies and make them more competitive internationally in the medium and long term.

In fact, the level of internal saving in the region, as a proportion of the product, has not changed to any great extent, with levels slightly lower than those recorded in the years preceding the crisis. As may be seen from figure 2, however, between 1983 and 1987 debt servicing payments absorbed almost one-third of that saving, forcing a reduction in productive investment and dimming the prospects for future growth.

The way in which the governments of the region have responded to this phenomenon has been a major determining factor of their economic policy. By subordinating growth targets to debt servicing, a number of countries --usually those with large economies-- have endeavoured to generate trade surpluses by pursuing the recessionary adjustment policies described earlier. In the early years of the decade, this strategy was based on two assumptions which subsequently turned out to be mistaken: first, that the international economy was going through a cyclical recession which would be succeeded by a recovery, with the subsequent spin-offs that would benefit the Latin American and Caribbean exporting sector; secondly, that the adjustment policies would quickly allow the countries of the region to regain access to the capital markets and thus return to their "normal" situation of net importers of financial resources. In the event, the trade surplus (achieved by an increase in exports but also through a much more dramatic compression of imports) was gained at the expense of the high social and economic costs so often referred to in this and other ECLAC documents.

This trade deficit, and the recessionary policies which generally accompanied it, bear witness to the extraordinary effort made by many of the governments of the region to keep up normal payments of their external debt servicing commitments, thereby demonstrating that they see their relationship with the international trade and financial markets as a long-term one, despite the present difficulties. However, with the passage of time and its cumulative effects, debt servicing has become an insurmountable barrier: it is obvious that for most of the countries growth is incompatible with the payment of the debt on the initially agreed terms.

## 2. Growth, saving and the transfer of resources

The main problem is that of substantially reducing the external debt servicing payments while obtaining a net flow of external financing. These service payments, coupled with the paralyzation of voluntary external financing, have meant a net transfer of financial resources to the creditors of some US\$150 billion between 1983 and 1987.

Table 6

**LATIN AMERICA AND THE CARIBBEAN: RATIO OF TOTAL INTEREST  
PAYMENTS TO EXPORTS OF GOODS AND SERVICES<sup>a</sup>**

(Percentages)

	1979	1980	1981	1982	1983	1984	1985	1986	1987 <sup>b</sup>
<b>Latin America and the Caribbean</b>	17.6	20.4	28.0	41.0	36.2	35.7	35.2	36.0	30.5
<b>Oil-exporting countries</b>	15.7	16.8	22.6	35.6	31.4	32.5	32.2	35.3	25.2
Bolivia	18.6	25.0	34.6	43.4	39.9	50.0	46.8	42.6	40.0
Ecuador	13.6	18.3	22.8	30.3	27.4	30.7	27.0	30.9	31.1
Mexico	24.5	23.3	29.0	47.2	37.5	39.0	36.0	37.9	27.9
Peru	15.5	18.4	24.1	25.1	29.8	33.2	30.0	26.7	22.4
Venezuela	6.9	8.1	12.7	21.0	21.7	20.1	26.2	32.8	26.3
<b>Non-oil-exporting countries</b>	19.3	23.9	33.8	46.8	41.0	38.7	37.8	36.3	33.0
Argentina	12.8	22.0	35.5	53.6	58.4	57.6	51.1	53.0	56.2
Brazil	31.5	34.1	40.4	57.1	43.5	39.6	40.0	41.4	34.5
Colombia	9.9	11.8	21.9	25.9	26.7	22.8	26.3	19.7	25.2
Costa Rica	12.8	18.0	28.0	36.1	33.1	26.7	27.3	21.2	19.3
Chile	16.5	19.3	38.8	49.5	38.9	48.0	43.5	38.6	26.7
El Salvador	5.7	5.9	7.8	11.9	12.2	12.3	12.9	12.5	13.2
Guatemala	3.2	5.3	7.6	7.8	8.7	12.3	14.9	16.5	16.3
Haiti	3.2	2.1	2.7	2.4	2.4	5.2	7.4	3.4	4.6
Honduras	8.6	10.6	14.4	22.4	16.4	15.8	16.2	15.5	16.5
Nicaragua	9.7	24.3	37.4	41.8	45.5	11.9	13.3	8.9	69.9
Paraguay	10.7	13.5	14.8	13.5	14.3	10.2	8.3	18.5	14.8
Dominican Republic	14.3	19.9	19.1	22.7	24.5	18.1	15.4	19.0	19.6
Uruguay	9.0	11.0	12.9	22.4	24.8	34.8	34.3	24.7	24.0

Source: 1979-1987: ECLAC, on the basis of official data.

<sup>a</sup>Includes interest earned, as well as interest payments on short-term debt. Services exclude factor services estimates.

<sup>b</sup>Preliminary estimates.

This transfer defies all logic. On the one hand, it might be expected that the resources would flow from the more highly capitalized countries to the other countries, as has historically been the case. On the other hand, it might be expected that the richer countries would help to finance the development of the less favoured ones, supplementing the savings of the latter with a part of their own, and thus facilitating greater investment. In contrast, however, the debt crisis has forced the debtor developing countries to set aside a substantial part of their savings to complement the savings of the more highly developed countries.

There has, it is true, been some progress in the successive negotiations carried out since 1983. The spreads over the reference rates have been reduced, and the latter rates have been changed in the sense that the lowest ones on the market are being used. The terms and grace periods have both been extended and mechanisms are now being used that link debt servicing to the prices of a number of export products; the growth rate of the economy has begun to be used as a factor for determining the need for additional resources, and "exist bonds" have been tried out in order to simplify the negotiating process. Furthermore, progress has been made at the conceptual level, since all the parties have recognized the need to adopt a longer-term approach to the problem of adjustment, the principle of the co-responsibility of creditor countries and institutions and of debtor countries in the debt problem has been accepted, and the need for growth in order to deal with the problem is now also recognized.

All this, however, has not been enough to counteract the continued deterioration in the terms of trade, the weakness of the world economy, the high interest rates, the growing protectionism and the violent exchange rate fluctuations that have hit the major world economies, and the abrupt withdrawal of voluntary external financing. In most countries, the burden of the external debt servicing as a percentage of the value of exports has only gone down very slightly, or not at all (see table 6).

It is therefore indispensable to examine the terms under which the debt could be serviced without this becoming an insurmountable obstacle to growth. The projections given in the previous chapter suggest that, in order to have growth while servicing the debt, a substantial reduction would be required in the interest rates charged or in the level of the outstanding debt. Thus, under the foreseeable market conditions, the debt for the region as a whole would have to be subject to interest rates of no more than 1% in real terms, and it would have to increase at the rate of 3% per year in order for the economies to be able to grow at modest rates of between 3% and 5% per year, depending on the countries. In order to achieve a similar effect without reducing the interest rate, the principal of the debt would have to be reduced by between 30 and 40% on average, with subsequent growth from that lower level. As already noted, these calculations could even prove to be optimistic if adverse conditions continue to prevail in the world economy and thus make even more difficult an increase in the exports of the debtor countries.

### 3. The debt and the market

The market has recognized these difficulties. On the one hand, the creditor banks have increased their reserves against possible losses on their loan portfolio. This means sacrificing present profits in order to strengthen their net worth and their future profits. A side effect of this strengthening of the banks' position is the more rigid stance adopted by some banks over requests for additional financing and over the pressures to meet those requests exerted on them by their governments or by multilateral financing agencies.

Another side effect, that has not been emphasized sufficiently, is the greater capacity of the creditor banks to reduce the interest charged to debtors who are experiencing payments difficulties and to write off all or part of those debts which they do not expect to be able to recover. Taken together, these side effects could lead to a situation in which, since additional financing has disappeared, the reduction of the interest and principal of the debt could become the chief means of solving the problem. A few banks have already adopted this course, either through negotiations with individual debtor enterprises (without State guarantee) or through more general formulas.

Furthermore, the market prices of the documents which constitute the State-guaranteed debt of the Latin American countries are substantially lower than their nominal value. This means that, at current interest rates and other currently prevailing conditions, the market considers that only a fraction of the debt can be recovered by the creditors (or paid by the debtors).

The debtors have so far derived little advantage from this difference in market price. Only if the debt is converted into risk capital and if this conversion takes place in the debtor country at lower values than the nominal value of the debt, will the debt burden be relieved in the long term. Otherwise, even though a fixed obligation is converted into a variable one, the desired rate of return on the investment could be expected to be higher than the interest rate on the loans, as has usually occurred in the past. Consequently, such conversion of the debt into equity cannot serve as the basis for the solution of the debt problem, although depending on the policies of the countries it can play a part, if it succeeds in stimulating investment.<sup>22/</sup>

Today, as in the past, the situation is one that the market alone can only resolve very inefficiently. What is needed is rather the reduction of interest rates through direct action by the creditors, the lowering of the original level of the debt, and the continued supply of financing to the debtor countries to permit the growth of their economies. The action of the market would lead to the paralyzation of financing and not an increase in it, despite the persistent efforts of the multilateral financial organizations to induce the banks to lend more.

Consequently, a set of complementary solutions must be devised. The revision of the interest rates charged, or of the current principal of the debt is of great importance in this respect. It therefore seems very unlikely that market solutions by themselves will solve the problem or that a single

solution can be found to relieve the debt burden, especially in view of the growing uncertainty as regards the growth of the world economy.

#### 4. The options open to creditors and debtors

In tackling the problem, the creditor banks are increasingly using a list or "menu" of market options formulated to satisfy their own interests and convenience, in the hope that the debtors will choose from among those options. The debtors, for their part, have succeeded in gradually expanding their own list of options so that to some extent it will reflect their interests.<sup>23/</sup> Recent additions to the list include the rescheduling of interest payments on an annual rather than a semi-annual basis and the linking of the amount of new financing to certain indicators of export income.

The creditor banks have not adopted a monolithic position vis-à-vis the debt problem. As a matter of fact, as the crisis has dragged on without any clear signs of a solution being found, more and more differences of approach and of emphasis have developed among the banks. In some cases, negotiations between them and the debtors have been unreasonably protracted because of the refusal of just one bank (or a few banks) to accept certain proposals made by the debtors which are acceptable to the vast majority of the creditors. In other cases, there have been long delays in actually disbursing the funds committed because some creditors only accepted the terms of the agreement very reluctantly.

Despite all this, the list of market options preferred by the creditors falls far short of solving the problem. Since the interest rates charged on the current debt must be brought down by direct means, or the debt itself reduced, it is necessary to go further in seeking options to achieve this end.

Consequently, the debtors' list of options should include at least the following:

a) Direct reduction of the interest rates charged on the current debt, both by the commercial banks and by the rest of the institutional creditors. Such a reduction is perfectly feasible as shown by the measures already taken by some institutions in a few cases.

b) Provision of additional external financing by the commercial banks in an amount at least equal to the application of the international rate of inflation to the principal of the debt owed to those banks. This would avoid the need for difficult negotiations aimed merely at preventing a reduction in the real level of the debt.

c) Revision of the rules governing the establishment of reserves and the writing-off of debts by the commercial creditor banks, to facilitate the recognition of the market value of the debt in their portfolios and to spread over a longer time the effects of such recognition on the banks' profits and/or capital, including (where appropriate) the total or partial writing-off of the debt in some countries.

d) The application by the governments of the creditor banks' home countries of accounting and banking supervision rules which facilitate sales of their portfolios by the commercial banks. Such rules should give greater recognition to the fact that reducing the liabilities of a given debtor improves the quality (increases the likelihood of payment) of the remaining debt.

e) The adoption of explicit measures by the creditor governments to alleviate the burden of the debt from official sources, which is not traded on the market. These measures, in turn, would make it less onerous for the creditor commercial banks to contribute to solving the problem.

f) The establishment (or strengthening, where appropriate) of mechanisms to soften the harmful effect on debtors of some of the policies of creditor countries, especially those concerning increases in interest rates or deterioration of the terms of trade. These mechanisms could be set up in the multilateral financing agencies. Some creditor countries have already expressed their support for such a measure.

g) The creation of special funds in multilateral agencies to purchase bank portfolios, at prices negotiated in line with the market prices of such portfolios. These agencies could then undertake to recover the debt once it had been reduced to its market value. The resources for establishing these funds would be provided in the form of loans from creditor countries on concessional terms. These loans would then be paid back from the proceeds of the collection of the debt obligations purchased. Alternatively, the agencies could issue bonds backed by the debt thus acquired and by their own guarantee, in order to finance the operation.

h) The strengthening of the capital resources of the multilateral and regional financing agencies, under revised conditions that facilitate the provision of anticyclical financial support to the debtor countries. In the case of many countries, these agencies have helped to create a negative flow of resources, by demanding payments of principal and interest that exceed the new loans being granted by them.

i) The issue by the debtor countries of bonds guaranteed by the creditor countries, for the repurchase of the former's debt at market-related prices so as to reduce the debt to a manageable size.<sup>24/</sup>

The relative importance of the various elements within a set of solutions would vary from one country to another, depending on the particular circumstances of its economy, its debt structure and its relationship with its creditors.

Moreover, there are some aspects of the debt problem that cannot be resolved solely by negotiation between the debtors and the creditor banks. On the one hand, for example, there are the problems linked with the basic functioning of the international monetary and financial system, while on the other there are the difficulties raised by conflicts between individual and collective interests which require action by a higher authority that oversees the general interest. These are the problems that call for a political

negotiation, involving the governments of creditor and debtor countries, as well as the creditor banks and the multilateral financial institutions.

In the same order of ideas, intra-regional co-operation among debtor countries --within the framework of the Cartagena Group, the so-called "Group of Three", the Rio Group or others-- offers obvious advantages and could improve the bargaining power of each of the debtors vis-à-vis their creditors.

At the same time, it should be noted that it is not enough merely to refinance or postpone all the debt maturities. Calculations indicate that, in addition to refinancing or postponement, fresh financing is also required, which could mean that the principal of the debt would continue to increase, even at substantially lower interest rates than the present ones. If interest rates are not reduced, then it is also necessary to add the amounts required to finance higher interest payments to the increase in the debt. This would mean that the debt would increase at a rate of around 9% per year, which is higher than the growth rate of the product or exports. If this occurred, the debt product and the debt export ratios would continue to increase, giving rise to fresh problems in the future.

Consequently, the reduction of interest rates is an indispensable component of any set of solutions. Naturally, instead of reducing interest rates the initial level of the debt could be reduced to such an extent that the interest payments would go down by an amount equivalent to that obtained by reducing the interest rates.

The necessary additional increase in financing would have to be provided by all the traditional sources: commercial banks, multilateral agencies and governments. Probably, however, the last two would initially have to play the leading role. Experience has shown that the commercial banks tend to withdraw for a long period after crises, and there is nothing to be seen in the present situation that could reduce this period of withdrawal.

##### 5. Unilateral options and de facto solutions

In the absence of formulas for relieving the debt burden which come from a substantial improvement in the world economy (which, as already noted, is not to be glimpsed on the foreseeable horizon), from some of the formulas described above or from others of a similar type, the debtor countries will be faced with the alternative of taking unilateral action for long periods. Several debtors have already been forced to restrict their debt servicing payments unilaterally, not only in Latin America but also in Europe and Africa. Such restrictions have also been applied in the past, during periods of recession in the world economy, and have helped to lighten the burden of the debtors. Just as occurs today, this unilateral restriction of payments was usually applied by the debtors because there were no other alternatives, and not as a preferred course of action.

If forced to adopt unilateral measures, the debtors could include on their lists other options such as moratoriums, specific ceilings for debt servicing payments (such as a percentage of the product or of exports), forced capitalization of all or part of the interest payments, the unilateral

conversion of the debt into long-term bonds with interest rates lower than current market rates, the payment of the debt in kind (already agreed on with some creditor countries with centrally-planned economies), and so forth.

Past experience has shown that in such cases the market is forced to accept the situation and to share the cost of such acceptance among all the interested parties. Such a solution, however, only comes after a long period of conflicts, paralyzation of growth, bankruptcy of some creditor institutions and widespread economic disorder, all of which could be avoided by taking timely concerted action.

Longer-term solutions to the debt problem would involve linking debt servicing to the external sector situation of the debtor countries, and especially with trade expansion. Such solutions also involve seeking better adjustment mechanisms in the world economy in order to distribute the burden of the adjustment more equitably and prevent a recurrence of the levels of internal and external imbalances that have been recorded recently. These imbalances, by increasing uncertainty in the world economy, seriously undermine the development process in both the industrialized countries themselves and in the rest of the international community. Because of their nature, these solutions can only be achieved through political negotiation involving both creditor and debtor governments.

Lastly, it should be recalled that the effort to solve the debt problem falls within a general framework of economic policies aimed at achieving faster and more stable growth in the economies of the region. This highlights the responsibility of the Latin American and Caribbean governments to improve their economic and social policies. A number of additional considerations are expressed on these matters in subsequent chapters.

Latin America's serious concern with the debt problem has once again been underscored by the attention given to the subject recently by the Presidents of eight countries of the region. The Presidents agreed on a set of action guidelines aimed at reconciling the priority need for growth with adequate servicing of the external debt. The Acapulco Pledge for Peace, Development and Democracy contains the fundamental guidelines for achieving this harmonization and proposes political negotiations in line with principles that have already been internationally accepted: co-responsibility, the need to reduce and reverse the negative transfer of resources, and the desirability of establishing mechanisms to alleviate the impact of the policies of the more economically influential countries on the economies of the developing ones. The way in which these guidelines are to be implemented is to be found in a list of options that reflect the interests of the debtors.

### C. GROWTH AND CHANGES IN THE STRUCTURE OF PRODUCTION

#### 1. Achieving a new form of insertion in the international economy and changes in the structure of production

The situation of the international economy described in the first chapter of this paper has been accompanied by far-reaching changes, with considerable technological consequences, in the structure on which world production is based.<sup>25/</sup> Among other things, these emerging technological patterns tend to affect the comparative advantages based on the primary exploitation of natural or energy resources as well as those which spring from the utilization of low-cost labour. However, they also tend to endow the pattern of comparative advantages with greater dynamism, in so far as these depend less and less on natural resource endowment or on the traditional capacities of each country and more and more on the development of human resources and the gradual acquisition of fresh technological and industrial capacity.

This accounts for the increasing sense of urgency surrounding the issue of the transformation or modernization of the productive structure and the incorporation of technical progress both in the developed and in the developing countries. It has already been mentioned in previous chapters that in the specific case of the variety of circumstances existing in Latin America and the Caribbean, and partly as a consequence of the changes taking place in the international sphere, there is an increasing awareness that the two main sources of economic dynamism between 1950 and 1980 —the export of primary commodities and industrialization, mainly for the purpose of supplying national markets— have gradually lost their capacity to galvanize.

This leads to the conclusion that if countries are to return to the path of growth, it is necessary, at least in the majority of cases, for them to endeavour to transform their productive structures, both in the agricultural sector and in manufacturing. The following pages lay stress on one of ECLAC's long-standing concerns —that of industrialization— in the context of the 1980s and beyond.

Experience in Latin America and in other developing regions indicates that if the overall objectives of development are to be achieved it is essential to simultaneously take steps to articulate the domestic economy and to achieve a sound insertion within the international economy. Any attempt to achieve this through partial and prolonged exclusion of social sectors and regions will prove illusory, since the latent tensions thus generated inexorably give rise to uncertainty and ultimately jeopardize investment and growth. On the other hand, focusing attention exclusively on domestic articulation at the expense of international insertion is increasingly perilous, both on account of the increasing transparency in the field of communications (and consequently in that of aspirations and patterns of behaviour) and of the even more undeniable fact that improvement of the population's standard of living is linked to the growth of productivity. This latter factor is in turn linked to the process of incorporation of technical progress, which requires growth, and the form of insertion in the

international economy is at one and the same time a means of access and a stimulus for achieving this.

## 2. Competitiveness and technical progress

However, the prospects for the reorganization of production in the developed countries and in Latin America and the Caribbean are radically different. In the case of the former, the prime motive is international competitiveness; in the case of the latter, during the present decade there has been a tendency to apply policies which, in furthering productive transformation, have sought as their main objective to generate a trade surplus. In its most extreme terms, the difference is between competitiveness through the incorporation of technical progress and that which is based on the reduction of income.

At the national level and from a medium and long-term perspective, being competitive involves possessing the capacity to maintain and increase the country's share in the international market, while simultaneously improving the population's standard of living. In order to do so it is necessary to increase productivity and hence to incorporate technical progress. In the short term, devaluation and other export-promotion policies can serve to improve the relative position of a country's productive enterprises. However, endeavouring to increase competitiveness on the basis of a series of devaluations instead of increasing productivity and incorporating technical progress leads to a gradual erosion of social cohesion, and in the last analysis jeopardizes the very objective of promoting the country's international insertion.

The governments of the developed countries undertake programmes designed to support sectors with a high technological content, reorganize and reinforce the educational, research and development system, promote programmes giving preferential support to small and medium-sized industry, establish favourable conditions for co-operation between enterprises as well as between enterprises and the public sector, undertake the reform of the system of industrial relations, and strengthen public investment programmes to improve the infrastructure, with special stress on telecommunications.

The enterprises, for their part, examine new forms of organization and co-operation with one another, as well as with universities and the financial sector (risk capital), try out various forms of industrial relations designed to promote co-operation and motivation on the part of workers, and also develop the most varied forms of co-operation between firms, as well as with governments and regional groups. This is of particular relevance in the sphere of research and development. These sectoral instruments are generally gathered under the generic term "industrial policy", and are usually in support of the international competitiveness of industry within a productive system which is spearheaded and articulated, both domestically and internationally, by sectors producing goods and services with a high technological content, from which progress spreads to the rest of the productive apparatus.

Latin America and the Caribbean face a far more complex task because, inter alia, of the manner in which technical progress is disseminated in the countries of the region. Beyond doubt, action of a sectoral nature designed to

diversify the productive structure, improve efficiency and productivity and in general to lessen or eliminate the relative backwardness of these structures and to achieve integration into the intense technological changes taking place in the world are necessary.<sup>26/</sup> The overall macroeconomic setting, and above all the adoption of measures designed to avoid the excesses of overprotecting those manufacturing activities of doubtful social usefulness also contribute towards bringing about the desired transformation. However, it is not sufficient merely to focus attention on the management of macroeconomic equilibria, which are by definition short-term phenomena, in the hope that the market will spontaneously bring about transformations of a structural nature. To do so is to lose sight of the fact that present relative prices may and generally do differ from those occurring in the course of long-term transformations inspired by and founded on far more complex objectives and criteria than those which govern the market.

International competitiveness is also linked to the capacity of countries to systematically tackle the design and implementation of integral policies in respect of renewable and non-renewable natural resources and to apply scientific and technological knowledge to the prospection, extraction and processing thereof. Ensuring that such exploitation remains within tolerable limits would constitute part of this effort, particularly in view of the need to reverse the trend of recent years towards over-exploitation of some of the region's natural resources, with its consequent and perhaps heavy cost in terms of ecological and environmental damage which severely strains the agro-ecological systems.<sup>27/</sup>

To sum up, if a limited concept of competitiveness is used, it may be said that in the 1980s the countries of Latin America have made significant progress in this respect. Unfortunately, however, in general this has not been the case,<sup>28/</sup> and while many countries in Latin America have generated a trade surplus, at the same time the level of income has declined.

### 3. Equity and technical progress

Modernizing the productive structure is also linked to other critical variables of economic policy which are connected with long-term structural changes and which concern patterns of consumption, distributive structures, patterns of investment as regards articulation between sectors, forms of international insertion, entrepreneurial and technological development, quality and nature of the physical infrastructure, and the natural resource base. In this respect, maximum use should be made of the natural heritage on the basis of techniques allowing a form of development which can be sustained from the environmental angle. A number of links between these critical variables are sketched out below, by way of illustration.

The starting point lies in the transformation of the agrarian structure, as the structural transformation of the agricultural sector has played a key role in a number of different cases of modernization. It is well known that the forms taken by this transformation, together with the social processes within which it takes place, have been extremely varied in past experience, but a factor of convergence is to be found in the fact that this phase has played a crucial role in the process of incorporating the peasantry into

modern society and in the modification of the relations between agriculture and industry, and has had a particular influence on the improvement of the levels of equity --and, consequently, on the patterns of demand-- which have characterized different societies as they entered upon the formative phase of their industrial structures.

An internationally competitive industrial system which is part of a social context within which a minimum threshold of equity has been achieved (agrarian transformation), can help to promote equity in the country in question by virtue of a relatively broader distribution of property, in association with the creation of small and medium-sized firms; the dissemination of labour skills; faster growth of employment linked to the dynamism of the international market, increased productivity and higher wages; the dissemination of education on a broader and more integrated social base as an indispensable requirement for sustaining international competitiveness and, finally, the dissemination of industrial logic, by both formal and informal means, throughout society as a whole. However, these features are not necessarily found in those cases where competitiveness is achieved at the cost of labour remunerations and where, in addition, the resources generated in the initial phase, instead of being channelled towards the incorporation of technical progress through investment, are directed towards consumption or towards the exterior.

In addition, on the basis of a variety of historical experiences of development, it could be argued that greater equity in respect of income distribution is compatible with greater austerity in consumption and, consequently, with growth. However, if it is really desired to promote domestic economic and social articulation and to improve the competitiveness of the national industrial system it is necessary to implement government policies designed to regulate the spread of imitative consumption patterns. The appropriate instruments to achieve this vary depending on the particular national cases, but in general terms those which have the greatest impact appear to be tariff measures, action to regulate consumer finance, tax measures, and a form of regulation which falls outside the economic sphere and which is connected to the degree of social consciousness of the need to harmonize progress towards modernization, which is a constant and legitimate objective, with growth and equity.

The initial expansion of the domestic market in respect of an increasingly broad range of goods and services associated with growth constitutes the irreplaceable basis of an industrial and technological learning process which is itself a prerequisite for a better type of insertion in the international economy. This "virtuous circle" of growth and competitiveness --from which the requirements of equity, austerity and technological apprenticeship are frequently omitted-- represents one of the central axes of all the successful experiences of "industrialization".

#### 4. Entrepreneurial capacity and technical progress

The existence of a national entrepreneurial base, both public and private and including a variety of possibilities for and forms of linkage with external investment, will undoubtedly constitute a decisive factor for the possibility

of constructing an internationally competitive agricultural and industrial system. The issue of entrepreneurial capacity is also connected with the existence of the sectors of workers, technicians and professionals, together with their respective trade union organizations. Besides affecting the nature of the social and political institutions, the kind of relationships which exist within the enterprise and the various branches of industry exert a decisive influence on the evolution of productivity and the absorption of technical progress, which accounts for the institutional innovations underway in the developed countries, to which reference was made earlier in this paper.

A further factor which reinforces the possibility of firmly establishing internationally competitive productive systems is the opportunity to gain access to the stock of technological knowledge available at the international level. Access to this international fund of technological know-how will naturally tend to strengthen the national entrepreneurial base, while conversely the existence of the national entrepreneurial base constitutes a decisive factor for assimilating such knowledge. The limited success achieved by scientific and technological development institutions in Latin America and the Caribbean --which multiplied during the 1970s in a number of countries in the region in similar institutional forms, despite the scanty resources available-- is partly accounted for by the domestic economic context and the manifest limitations of those economic agents who had to play the leading role in the task of absorbing, applying and seeking this type of knowledge.

##### 5. Guidelines for reorganizing the structure of production

Acknowledgement of national characteristics, together with the general observations set out above, is compatible with the identification of a set of topics capable of serving as guidelines for the necessary reorganization of production. A number of criteria capable of contributing to the examination of some of these topics at the national and regional level are sketched out below.

First of all, with regard to sectoral priorities, the reorganization of production covers both the rationalization of installed capacity and the expansion of production in specific sectors. In those countries in which industrialization took place earlier, the first of these tasks will be the greater one and will perhaps encounter more serious obstacles arising from the possible attitudes of the entrepreneurial, labour and government groups directly affected in the short term. Consequently it is essential to encourage a concerted view of the need to carry out this reorganization, both in the case of those actors who participate directly and in respect of society as a whole. The process of rationalization of production may be more extensive in the durable and non-durable consumer goods sector, where, in addition, it is essential to considerably expand the domestic market.

As far as the creation of fresh productive capacity in the industrial sector is concerned, the following three principal axes seem to offer the greatest dynamic potential. Firstly, increasing the degree of processing and improving the design of those products for final consumption which make intensive use of the resources available in the region (agriculture, fishery, forestry, mining, energy), and which, in addition to satisfying local

requirements, also meet those of the international market; secondly, selectively promoting those productive activities which simultaneously satisfy the dual requirements of introducing technical progress while constituting the main pivot of articulation between sectors (capital goods and the chemical industry);<sup>29/</sup> and thirdly, incorporating on a realistic basis the so-called "spearhead" technologies (including information technologies, new materials and biotechnology).

With regard to this latter aspect, there is consensus over the need for the countries of the region to keep up with the rapid development and horizontal dissemination of these technologies throughout a broad and ever-widening range of goods and service-producing activities. So far, information technologies (microelectronics, communications and telecommunications) have spread in a number of goods-producing sectors (mainly machinery, equipment, manufacturing processes and consumer durables) as well as services (mainly telecommunications networks, professional and management services and financial systems), and there are increasingly close links between both of these broad sectors (the nucleus constituted by goods and services with a high information technology content).

Furthermore, there is an obvious need to achieve a sectoral and temporal combination between the external and domestic markets and to endeavour to ensure they support each other. However, it must be borne in mind that the difficulties encountered in penetrating international markets,<sup>30/</sup> particularly in the case of products with a higher technological content and under present world circumstances, are greater than those faced when substituting imports in protected domestic markets. If what is sought is efficient import substitution, the difference in the degree of difficulty involved in attaining both these ends diminishes somewhat, but nonetheless persists.

In order to penetrate international markets and consolidate the presence in them of products sensitive to technical change, which represent a growing share of world trade, it is essential to develop domestic institutional capacity to keep up with the unending process of innovation and modifications in the structure of world supply and demand. The smaller the domestic market, the greater the significance of the external market, but at the same time, the greater the obstacles faced in attaining the critical productive, technological, commercial and financial mass necessary to back up penetration of the world market: a fact which underscores the importance of subregional and regional integration. In addition, specialization chosen essentially on the basis of the demand profile of the developed countries, may, in the less-developed countries, further accentuate domestic economic and social exclusion and thereby even jeopardize this form of international insertion.

In the past a number of countries in the region tacitly opted for a combination of products of "international quality", subsidized for export purposes, and products of "national quality" sold on the domestic market, sometimes at high prices. Both domestic and external economic circumstances indicate the need to move towards a different kind of combination: a reduction in subsidies for products of international quality, whose weight in the total should increase, together with an improvement in the quality of less complex products, for which, moreover, there exists considerable

potential in South-South trade. The potential market for goods and services whose degree of technological complexity is compatible with the prevailing income of three-quarters of the world's population is significant, but taking advantage of it --just as in the case of penetration of the markets of the developed countries-- calls for a considerable effort of creativity and domestic organization.

Thirdly, reinforcing the capacity of the leading groups and of small and medium enterprises, as well as furthering the articulation between them, constitutes at one and the same time a requirement and a central objective of the reorganization of production. It is worthwhile taking account, in the reflection underway in Latin America, of those transformations which are in progress in the entrepreneurial sphere at the world level. As a result of the intensification of competition, the emergence of new technological patterns and the rapid changes in market preferences, a tendency has arisen to make innovations both in the organizational structure of enterprises and in the type of relationships between them: in both cases there is a tendency to replace vertical hierarchical relations by those characterized by horizontal co-operation. The fundamental criterion is that of flexibility: on the one hand, in order to incorporate technological innovation, and on the other, in order to adjust to the changing conditions of demand, within a context of intensified international competition.

This overview points to the desirability of encouraging, in the most diverse regional bodies, the presence or creation of links between private and public entrepreneurial agents and the other social and political agents. At the present time, except in specialized entrepreneurial spheres, mutual awareness and contacts between entrepreneurs of different countries and between them and the trade union, academic, cultural and governmental spheres are clearly inadequate.

Fourthly, reorganization of production assumes the existence of flows of investment resources between the productive sectors. This process involves enterprises, the financial system and the public sector, in varying degrees and with different reciprocal links depending on the different countries. The level of indebtedness of enterprises with the financial system, as well as the latter's solvency, differs from one situation to another, as does the type of relationship between productive enterprises, private banks and the public sector, to which must be added the diversity of experience in respect of the level of development and institutional forms. What is really worth stressing, however, is the fact that reorganization of production requires long-term finance, so that it is essential to set up the relevant institutional mechanisms.

As far as the infrastructure of education and technological research and development is concerned, this constitutes a fundamental requirement and ingredient for reorganizing production and achieving greater technical progress. This accounts for the increased resources allocated to research and development in the industrialized countries since the end of the 1970s up to the present, and also the intensification of the debate over the need to alter the educational system in order to adapt it to the new requirements. This is in contrast with the overall decline in resources allocated for the same purposes in Latin America and the Caribbean during the 1980s. In addition, it

would be necessary to make far-reaching alterations in the educational system and in the development of technology at the level of productive enterprises, as well as in the application of existing scientific and technological knowledge to productive activity.

Innovations are also necessary to heighten society's perception of the importance of these activities, and to achieve a clear awareness that they constitute an investment deserving priority and are not merely a form of current expenditure which can be dispensed with. Conditions must also be created to allow such Latin American talent as is at present to be found in academic institutions and leading enterprises in the developed countries to be recovered, while there should be a change in the evaluation criteria now used, which assign greater weight to certain low-cost areas of basic research likely to lead to international publications, to the detriment of basic or technological research which is more costly, involves greater risk and requires more time to bear fruit. Regional co-operation in these spheres, as has been clearly demonstrated by the European experience, constitutes an imperative which can no longer be set aside.

Finally, it will be difficult to carry out a transformation as far-reaching as that required by the present circumstances if it is not fully grasped how urgently it is required, or --which amounts to the same thing-- how deep an impact postponing or failing to make the changes would have on most of society. This means that the issue should be incorporated into the national and regional political agenda: a task in which the media and the educational process can play a decisive role. This issue consequently constitutes a challenge requiring a considerable period in order to find a solution and put it into practice. The depth, scope and stability of domestic political agreements relating to the need to modernize the productive structure are consequently of vital importance.

#### D. GROWTH AND EQUITY

##### 1. Inequality, social conflict and growth

Many publications, both by the Secretariat and by various other authors and institutions, include among the main shortcomings of the style of development prevailing in Latin America and the Caribbean during the three decades following the war its tendency towards concentration and exclusion.<sup>31/</sup> The unequal distribution of income and the persistence of the phenomenon whereby large numbers of people live in conditions of extreme poverty are widespread features of this style of development.

The crisis experienced in this decade has aggravated those characteristics, as reflected in growing levels of unemployment and underemployment, diminished access to social services, a lessening of real wages and hence a lowering of the levels of consumption of middle- and low-income sectors and, in general, fewer opportunities to rise on the social scale. At the same time, however, this period has also coincided with a tendency towards more pluralistic and participative political régimes providing various social groups with greater opportunities to organize in

order to seek certain demands. Thus, the present situation is now an ambivalent one as regards the possible causal relationship between inequitable economic and social schemes and political tension. On the one hand, the reconstruction or consolidation of democratic systems has possibly rendered the sacrifices made by the population in terms of well-being more bearable. On the other, the legitimacy of governments may be undermined by their incapacity to respond to the aspirations of those groups of people whose expectations of social mobility are affected.

Political divisions and conflicts, aggravated in some cases by the economic crisis, obviously weaken the stability and social cohesion needed if any systematic and permanent development effort is to advance. Thus, what it is sought to highlight here are the positive aspects of the relationship between equity and growth. A higher degree of equity in any given society is apt to make the people in that society more willing to participate in the effort required for embarking on long-term options favouring growth. Growth, for its part, tends to make inequality in the distribution of income easier to bear than in situations where stagnation prevails. This is not to say that growth results spontaneously in equity (the contention that it does has been systematically refuted by the experience of Latin America and other regions) but only that the adoption of policies favouring equity is facilitated in a dynamic context.

On the other hand, equitable development appears to be the only thing which can ensure the social cohesion and political stability that constitute the foundation of all development. In this respect, there are many theoretical studies and much practical experience which show that it is conceptually possible to harmonize the objectives of growth and of equity and that these two aims may even be mutually supportive.<sup>32/</sup>

## 2. Equity and economic policy

As already noted, it is conceptually feasible to reconcile the objectives of growth and equity, or at least to incorporate the objective of equity in the formulation and implementation of short- as well as medium- and long-term economic policy. In seeking to achieve equity in short-term economic policy, control over the macroeconomic balances should be combined with measures to foster growth and raise the standards of living of the majority sectors of the population. As recent experience shows, the application of such policies presents considerable difficulties; however, the possibility of devising a heterodox, expansive and equitable approach to the present economic situation depends on it.

In the last analysis, however, inequality in the distribution of income depends on factors relating to the productive, social and institutional structures. These factors include unevenness in productivity, the unequal capacity of social groups to defend their level of income, and the tendency towards increasing concentration of the ownership of productive assets. These are the kinds of factors which must be taken into account in medium- and long-term economic policies. It is basically a matter of directing growth in such a way as to reverse its persistent tendency towards concentration and exclusion. In this connection it should be noted that not only would the

criterion of equity be advanced by a less unequal distribution of assets, but it should also be accorded special attention when deciding what direction the productive effort should take. In taking that decision, emphasis should be laid on action to raise the standard of living of the lower income groups by applying measures aimed at increasing their productivity and volume of production. The support of peasant farming is a particularly promising line of action in this respect, as is the stimulation of small and medium-sized business and even informal activities.

Increasing the level of income of the poorest strata of the population is an essential requirement if internal markets are to be expanded, and it also plays a role in the expansion of supply. Past experience shows that the marginal consumption propensity of these strata is concentrated on goods and services which do not necessarily require many imported inputs and whose production is labour-intensive. Thus, there would be a better relationship between production, employment, growth and equity. Branches of economic policy obviously related to equitable development include the policies on State income and expenditure; prices (especially when aimed at eliminating factors which militate against rural development); credit; wages, and employment.

Policies aimed at both growth and equity should also take account of environmental factors, particularly those which have an impact on the more deprived sectors. In this connection, it should be noted that the quality of life of the population is affected more and more every day by environmental problems due to increasing pollution and the depletion of natural resources.

As pointed out by a number of governments of the region, the success of measures such as those referred to, which involve a substantial shift in the direction of the development effort, depends not only on the proper design of the economic policy but also on its being based on an agreement between the different social groups concerned. An agreement of this type should be envisaged as the starting point of a systematic effort to achieve a political consensus on the economic and social process, based on the principles of democratic participation by all groups, total transparency of the decision-making process, and equitable distribution of the sacrifices and benefits related to development. In striving to meet this objective, it will be important to reach general agreement at least on the policies in the areas of prices and wages, State income and expenditure, and savings and investment.

### 3. Equity and social policy

In Latin America and the Caribbean, there has been a tendency to separate economic policy from social policy, subordinating the latter to the dictates of the former, and to think that social policy is the only factor responsible for equity. This approach has favoured the coexistence of an economic policy which often furthers the concentration of wealth and income and a social policy which attempts to compensate for the resulting inequalities.

If an equitable concept of development is to win the day, it is essential to change this approach; concern for equity cannot be confined to the social services but must pervade every area of economic and social policy. Social problems and their solutions must be given a place in development thinking,

and their isolation and subordination to the objective of economic growth must be avoided. Confining concern for equity to the area of social policy means preventing the solution of long-term problems in this field.

The encapsulation of social policy has been very much aggravated by the internal division of that policy into "sectors" or "problem areas". For a long time stress has been laid on the need to view social questions integrally so as to eliminate partial treatment of them and to be able to handle them in a unified manner;<sup>33/</sup> some advances have been made at the level of ideas, but the achievements at the institutional level have been much fewer. This has meant that frequently it is the processes of decision-making and execution of social policy which show the worst defects as regards institutional disarticulation and overlapping of functions. It is vital to persevere in the efforts being made to achieve a coherent approach to social policy (and to its links with economic policy) and to ensure that such efforts are reflected in the institutional arrangement of the State machinery.

This does not necessarily mean an increase in bureaucracy, technocracy or State authoritarianism. On the contrary, what must be sought is participation by the users of services in their design and delivery, combining democratic central planning with new forms of deconcentration and decentralization. Strengthening managerial and organizational ability at the local level seems to be the best institutional means for raising efficiency in the application of social policies.

A system which fosters local participation will make it possible, in the first place, to perceive the shortcomings which exist with greater clarity. Secondly, it will make it easier to establish close links between the population concerned and the State apparatus. Thirdly, only under such a system can the members of that population participate in the process of taking decisions relating to public action and in revising or redirecting such action.

Such participation would be much more effective if both the public sector and the participants agree on some basic criteria concerning their respective responsibilities.

#### 4. Increasing and reorienting public spending in the social sector

The expansion of social sector spending does not necessarily mean promoting equity at the expense of growth; on the contrary, it may directly and simultaneously favour both objectives. Indeed, macroeconomic strategies on unorthodox lines assign a decisive role to increasing the effective demand of the medium- and low-income strata in promoting growth, since defending their living conditions helps to make the entire economy more dynamic.

The countries of Latin America differ greatly as regards the levels of their social public expenditure. Some devote close to 20% of their GDP and 50% of their total public spending to social needs, whereas in others social expenditure amounts to only half or less of these figures.<sup>34/</sup> At all events, per capita public spending in the social sector, even in the most advanced

countries of the region, falls a long way short of that of the developed countries; if, in addition, the marked inequality in the distribution among the social strata of the benefits of such expenditure is taken into account, it may be concluded that such benefits can hardly be said to reach a sizeable share of the population of Latin America.

The growth of social expenditure, which had been more or less rapid in all the countries in the preceding decades, has stagnated or declined in the majority of them during the 1980s because of the crisis. In the relatively less well developed countries of the region, this has had a devastating effect on social services, and its impact has been particularly high in the more vulnerable groups. The consequences have been far-reaching, and are becoming more severe as the situation continues year after year. In addition, the reduction in resources has been accompanied by an increase in demand since the middle-income strata try to check the deterioration in their living conditions by demanding more from public health, education and housing services. This often leads to a reduction in the response to the demand for such services, or else, when the demand is met, the price paid is the reduction of social investment, the saturation of existing capacity, a decrease in the wages and salaries of the personnel involved, cuts in the number of new programmes and other measures which affect the quality of the services.

In these circumstances, the concern for equity must also take the form of an effort to ensure that per capita spending in the social sector is soon brought back to the level at which it stood prior to the crisis of the 1980s and that the growth in social expenditure which was abruptly interrupted by the crisis is resumed. Although this objective comes into conflict with the policy of financial austerity which prevails in the region, there are other considerations which deserve to be taken into account in order to reverse recent trends.

Above all, it might be possible to explore the possibility of reallocating the resources included in total public spending in such a way as to increase those allocated to social sectors and reduce those assigned to less urgent activities, defence and investment in disproportionately large or low-priority projects. Of still greater importance, even in terms of the considerations of macroeconomic balance explored in the next chapter, is the potential offered by tax reforms, which would make it possible to increase fiscal income, especially by raising the taxes levied on the higher-income strata. Thought should also be given to the heavy burden on government spending represented by the payment of interest on the external debt; a reduction in these payments would make it possible, *inter alia*, to increase expenditure on social items, especially those directly connected with the above-mentioned goal of strengthening growth and equity at one and the same time.

Expenditure in the social field must not only be increased but also reoriented. On the one hand, special emphasis should be placed on the protection of the most vulnerable groups suffering the worst symptoms of extreme poverty; on the other, there is a need to lay the foundations for a long-term strategy of structural change aimed at securing equitable growth. For instance, thought should be given to making a relative reduction in services whose cost is very high (and whose scope is, in the final analysis,

limited) in favour of lower-cost services which cover the most basic needs of the people. Thus --although it is not suggested of course, that this principle should be applied simplistically-- expenditure on preventive medicine, immunization, oral rehydration and the basic training of large numbers of paramedical personnel could be considered more effective than spending on the construction and maintenance of large hospitals with sophisticated equipment. Similarly, a given volume of money spent on primary education may, in the short term, benefit more needy people than the same amount spent on university education. However, these kinds of policies should not be allowed to retard the social development of those strata which, although they have just barely surpassed the poverty level, lack the capacity to purchase on the market such items as vitally needed curative medicine or middle and higher education for their children. Thus, the suggested reorientation should be directed above all towards increase in the amounts spent on social action.

There are many social policies and forms of social expenditure which allow the first steps to be taken in a long-term strategy to increase the control of the masses over productive resources while at the same time very rapidly improving their living conditions. Emergency employment programmes for building infrastructure (roads and local irrigation systems in depressed rural areas, housing, paving and community centres in marginal urban neighbourhoods); combining primary health care with the provision of food and minimum-level scholarships to allow attendance at educational centres at various levels; direct support of community self-help building efforts; multi-faceted support of micro-enterprises and co-operatives for credit, production and marketing which employ people who are out of work or retired; and technical training programmes for adults are all examples of this kind of action.

In the medium and long term, education is the area of social action most capable of helping to maintain adequate economic dynamism. In particular, the training of high-level national and regional cadres in the fields of science and technology is a clear requisite for the creation of competitive capacity in manufacturing and specialized services oriented towards the international market. Furthermore, the educational system can carry out the role it has traditionally played in more egalitarian societies --that of a key device for creating greater equality of opportunity by providing low-income strata in both urban and rural areas with technical know-how and training.

Finally, an objective which is just as important as increasing and reorienting public spending is that of redefining the way in which the supply of social services is organized. What is needed is to increase efficiency and rationality in the provision of such services, especially since there is now considerable dispersion among the institutions responsible for them, which results in poor co-ordination of the system as a whole, overlapping of functions, rigidity in the management of resources and difficulties in carrying out a joint policy. The reorientation of social policy calls for a high level of coherence at the top of the system in order to facilitate the formulation and implementation of policies and the territorial decentralization of the provision of services. This would make it possible to increase the participation of the communities in the taking and execution of decisions; to enable social services to cover all their users' needs; to use a

community's potential to achieve social goals, and to make the organization of the services less bureaucratic.

#### 5. Equity and some special sectors

A selective approach must necessarily be used in applying policies to improve the distribution of income and reduce extreme poverty. This means that certain strata of the population or certain regions must be specially singled out as the object of various combinations of policies. Using such an approach it would be possible, for example, for certain policies whose impact is not very specific (such as generalized subsidies for food or inputs, broad nutritional complementation programmes and the like) and whose benefit/cost ratio is low to be replaced by programmes directed at specific groups.

The delimitation of the "target population" is a key element in the effectiveness of measures designed to alleviate social deficiencies. The more precise the socio-spatial delimitation of a population at risk, and the more detailed the description of the nature and extent of their needs, the greater the possibility of devising differentiated and specific measures. In this connection, some special observations would be in order concerning the urban and rural masses who confront very special problems and account for most of the people who live in conditions of poverty.

With regard to the urban population, for the great majority of marginal groups the only way of obtaining income has been to take jobs of low productivity where there is very little stability and wages are low and sporadic. This induces the members of such groups to engage in a number of different occupations simply in order to survive. There is an urgent need for a strategy to reactivate economic growth which is accompanied by special programmes to take care of the most urgent needs of the various components of this stratum.

A concrete formula for creating employment is to carry out massive projects for the construction of housing and provision of infrastructure oriented towards the needs of the middle- and low-income groups. These projects could be carried out with the resources set aside in many countries for emergency employment programmes, since such projects not only mitigate unemployment but also raise the living conditions of these sectors. They should make use of technological options which are labour-intensive and require materials and inputs of national origin, so as to produce a multiplier effect which will help to reactivate other areas of the economic structure. Among other specific projects to help increase the income of these sectors are the strengthening of existing micro-enterprises through technical assistance and credit, and the creation of co-operatives for purchasing the most widely used inputs, in order to lower their cost and make the micro-enterprises more competitive.

In order to prevent the reproduction of extreme poverty from one generation to another, a very important segment that must be taken into account in the provision of social services, is that made up of mothers and children. With regard to these persons, health, education, nutrition and

complementary food policies are of the greatest importance in order to ensure the presence of the conditions needed for normal child development.<sup>35/</sup>

With regard to the low-income strata in rural areas, the economic crisis of the 1980s has cast new doubt on the theory that a dynamic trend was at work which would enable the active population employed in agriculture to be reduced through training and absorption in productive employment in other sectors, together with increases in the productivity of the labour force remaining in agriculture. This trend is now being threatened by a combination of long-standing unresolved problems and the recent accumulation of a new social deficit in rural areas associated with the collapse of the urban labour markets during a number of years.

The problems referred to vary in gravity and in the degree of rapidity with which they are accumulating, depending on the particular circumstances of each country. In general, in those countries where the demographic and occupational transition is of more recent date or is only just beginning, the rural environment provides obvious opportunities for the integration of both economic and social policy, since the population associated directly or indirectly with the peasant economy is characterized, on the one hand, by a larger percentage of people living in poverty, while on the other hand it is responsible for producing a significant share of the basic foodstuffs for mass consumption. Moreover, the units making up that population have the potential capacity to generate a larger supply of basic foodstuffs per net unit of imported input requirements. They can also achieve a higher component of employment per unit of product generated and require a smaller price increment as an incentive for increasing the supply of their products or services.

The general criterion which should govern the design of specific action in this field is that of seeking action formulas which turn flows of assistance into income-generating assets. The peasantry's great heterogeneity as regards its productive potential means that the measures necessary to apply this criterion will be different, in terms both of content and of periods of maturity, in the individual units which make up the sector as a whole. In designing specific and differentiated policies for each type of producer it will therefore be necessary to distinguish between at least three categories.<sup>36/</sup>

The first category is that of producers with land of adequate quality or quantity, whose primary problem is their lack of access to modern inputs, financing and markets. In this case, results could obviously be achieved in the short term by establishing mechanisms to ensure such access. The existence of an institutional framework would make it possible to determine the magnitude and nature of the limitations existing in each locality, and organization of the producers would serve to keep the action undertaken from depending solely on the authority or capacity of the bureaucracy.

The second category consists of producers whose land is insufficient, in quantity or quality, to permit them to cross the poverty threshold even if the available technology were applied. In these cases, land redistribution, soil improvement, investment in small irrigation schemes and an attempt to find new techniques for raising the productive potential of the units concerned would

be examples of possible action, together with a policy to subsidize consumption while these measures were taking effect.

Finally, there is the category of landless workers. For those who are part of the casual or permanent labour force of entrepreneurial agriculture, the organization of trade unions is one way by means of which their living conditions could be improved, both through the negotiation of wage increases and through the creation of other institutions to improve their lot. In the case of persons who are temporarily or permanently unemployed, the obvious alternative lies in the implementation of various kinds of rural public works through basic employment programmes designed to improve the social infrastructure for the benefit of the "territorial group" to which these workers belong.

When the unemployment problem is seasonal the employment policy could be anti-cyclical in nature. It should be designed to promote activities which do not demand continuity throughout the year and are either not characterized by seasonal rigidity, or, if they are, can be organized to complement the periods of greatest demand in the crop-growing season by promoting the creation of non-agricultural rural activities such as small and medium-sized food enterprises, tool manufacture, services and cottage industries. In addition, as a long-term task, the "ruralization" of industry may, in many cases, be the only way of providing for the stable, sustained growth of rural income.

## E. GROWTH AND THE CONTROL OF INFLATION

### 1. Nature and scope of the problem

The constraints which have restricted growth in the countries of the region, especially those of external origin, have also had a hand in the rapid acceleration of inflation. Price instability has thus become yet another restriction on sustained growth. During the crisis inflation has, in fact, tended to spread throughout the region, and in six countries it has gone beyond three digits. In addition, this sharp escalation has affected a number of countries previously characterized by relatively low inflation (see table 7).

The origin of this phenomenon is complex and is to be found in a combination of factors of both internal and external origin. Those of internal origin include factors associated with the implementation of economic policy and in particular with structural phenomena usually related to the conflicts regarding distribution referred to in the previous chapter. In this chapter, however, emphasis is placed on factors of external origin: that is to say, on the way in which external restrictions impact on price stability.

There are three interrelated phenomena linking external restrictions with the worsening of inflationary tensions. The first of these has to do with the impact of the external debt servicing on public finance. The mobilization by the public sector of additional resources amounting to between 4% and 6% of the gross domestic product for these purposes could be accomplished through three non-inflationary financing alternatives --by going further into debt in

Table 7

## LATIN AMERICA AND THE CARIBBEAN: EVOLUTION OF CONSUMER PRICES

(Variations from December to December)

	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987 <sup>a</sup>
<b>Latin America and the Caribbean</b>	39.0	54.1	56.1	57.6	84.8	131.1	185.2	275.3	64.6	187.1
Argentina	169.8	139.7	87.6	131.2	209.7	433.7	688.0	385.4	81.9	178.3 <sup>a</sup>
Barbados	11.3	16.8	16.1	12.3	6.9	5.5	5.1	2.4	-0.5	3.7 <sup>b</sup>
Bolivia	13.5	45.5	23.9	25.2	296.5	328.5	2 177.2	8 170.5	66.0	10.5 <sup>c</sup>
Brazil <sup>d</sup>	38.1	76.0	95.3	91.2	97.9	179.2	203.3	228.0	58.4	337.9 <sup>e</sup>
Colombia <sup>f</sup>	17.8	29.8	26.5	27.5	24.1	16.5	18.5	22.3	21.0	24.7 <sup>e</sup>
Costa Rica	8.1	15.2	17.8	65.1	81.7	10.7	17.3	11.1	15.4	15.6 <sup>f</sup>
Chile	30.3	38.9	31.2	9.5	20.7	23.6	23.0	26.4	17.4	22.9 <sup>g</sup>
Ecuador <sup>h</sup>	11.8	9.0	14.5	17.9	24.3	52.5	25.1	24.4	27.3	30.6 <sup>e</sup>
El Salvador	14.6	14.8	18.6	11.6	13.8	15.5	9.8	30.8	30.3	21.2 <sup>e</sup>
Guatemala	9.1	13.7	9.1	8.7	-2.0	15.4	5.2	31.5	25.7	8.5 <sup>i</sup>
Guyana	20.0	19.4	8.5	29.0	19.3	9.6	...	...	...	...
Haiti	5.5	15.4	15.6	16.4	4.9	11.2	5.4	17.4	-11.4	...
Honduras	5.4	22.5	11.5	9.2	8.8	7.2	3.7	4.2	3.2	1.8 <sup>e</sup>
Jamaica	49.4	19.8	28.6	4.8	7.0	16.7	31.2	23.9	10.4	5.6 <sup>f</sup>
Mexico	16.2	20.0	29.8	28.7	98.8	80.8	59.2	63.7	105.7	143.6 <sup>e</sup>
Nicaragua	4.3	70.3	24.8	23.2	22.2	32.9	50.2	334.3	747.4	1 225.7 <sup>e</sup>
Panama	5.0	10.0	14.4	4.8	3.7	2.0	0.9	0.4	0.4	1.0 <sup>e</sup>
Paraguay	16.8	35.7	8.9	15.0	4.2	14.1	29.8	23.1	24.1	23.5 <sup>e</sup>
Peru	73.7	66.7	59.7	72.7	72.9	125.1	111.5	158.3	62.9	104.8 <sup>e</sup>
Dominican Republic	1.8	25.6	4.6	7.3	7.2	7.7	38.1	28.4	6.5	17.4 <sup>e</sup>
Trinidad and Tobago	8.8	19.5	16.6	11.6	10.8	15.4	14.1	6.6	9.9	11.4 <sup>e</sup>
Uruguay	46.0	83.1	42.8	29.4	20.5	51.5	66.1	83.0	76.4	59.9 <sup>e</sup>
Venezuela	7.1	20.5	19.6	11.0	7.3	7.0	18.3	5.7	12.3	36.1 <sup>e</sup>

Source: International Monetary Fund, *International Financial Statistics*, November 1987, and information supplied by the countries.

<sup>a</sup>Preliminary figures. <sup>b</sup>Corresponds to variation between July 1986 and July 1987. <sup>c</sup>Corresponds to variation between November 1986 and November 1987. <sup>d</sup>Up to 1979, corresponds to variation in the Consumer Price Index for the city of Rio de Janeiro; from 1980 onwards, corresponds to variations in the nation-wide index. <sup>e</sup>Up to 1980, corresponds to variation in the Consumer Price Index for manual workers; from 1981 onwards, corresponds to the variation in the nation-wide index for both manual and non-manual workers. <sup>f</sup>Up to 1982, corresponds to the variation in the Consumer Price Index for the city of Quito; from 1983 onwards, corresponds to the variation in the nation-wide index. <sup>g</sup>Corresponds to variation between September 1986 and September 1987. <sup>h</sup>Corresponds to variation between October 1986 and October 1987. <sup>i</sup>Up to 1982, corresponds to the variation in the Consumer Price Index for the city of Santo Domingo; from 1983 onwards, corresponds to variation in the nation-wide index. <sup>j</sup>Corresponds to variation between August 1986 and August 1987.

the internal market (sometimes at the price of raising that market's interest rates); by establishing higher taxes, or by decreasing public expenditure. Although the majority of governments chose to apply a combination of these three measures, each measure involved difficulties and awakened resistance of various kinds, placing limits both on tax rises and on spending cuts, especially in consumption expenditure. Thus, in view of the limited absorption capacity of internal capital markets, many governments were faced with the necessity of resorting to the issue of new currency and to the "inflation tax" in order to finance the growing costs of servicing their external debt.

The second phenomenon is related to the machinery for converting resources collected in national currency into foreign exchange. Since not all goods can be traded internationally, this means that the smaller the proportion of tradeable goods in the product and the slower and more arduous the process of reallocating resources from the production of non-tradeable goods to that of tradeable goods, the greater will be the potential recessive cost, the greater the devaluation required to achieve such a change, and, in the last analysis, the more serious the resulting inflationary pressures.

The change in relative prices to favour tradeable goods will make the problem of mobilization even more difficult. If the public sector has a foreign exchange deficit, as it has in the majority of Latin American and Caribbean countries, then devaluation, though helping to generate foreign exchange for the economy as a whole, will increase the public sector's deficit at the same time.

In the third place, mention should be made of the inertia factor of inflation. The impact of mobilizing and transferring resources is greater when --as happens in countries with a long history of inflation-- there are mechanisms which tend to reproduce the inflation experienced in one period in the following period, more or less automatically. Thus, once a major large component of inflation is inertial and inflationary expectations and indexing mechanisms have become generalized, any substantial disturbance in prices speeds up the inflationary process sharply rather than merely occasioning a single, once-and-for-all price increase.

In summary, although the problems described (budgetary problems, mobilization, conversion and inertia) and the way in which they are interrelated are not the only factors which help to accelerate inflation, they do make it easier to understand the increase in inflationary pressure in many countries during recent years.

## 2. Policies for controlling inflation

The experience gained in the 1980s in the application of diverse stabilization programmes inside and outside the region has provided important lessons not only in the realm of economic policy but also in the political and social fields. In this latter field this experience has shown up the limitations of economic policy as regards the impact of the cost of such programmes on the various strata of society. As for economic policy, it has been made clear that stabilization programmes must contain a combination of elements which, at the

very least, take care of each of the three basic needs noted earlier: i.e., the need to exercise greater control over budgetary imbalances, as an important component of aggregate demand; the need to convert income in national currency into foreign exchange, and the need to control and guide inflationary expectations. The combination of policies necessary in order to cope with each of these needs and the scope of their application must, of course, vary according to the relative importance of these needs in each country.

Thus, policies designed to control prices and income and to bring about de-indexing were effective in bringing about an abrupt lowering of inflation in cases where the inertial component of inflation was much higher than the basic or structural component (Argentina, Brazil and Peru). However, as some of these experiences suggest, when such policies are not accompanied by other policies for readjusting relative prices and keeping aggregate demand within prudent limits, there is a danger that the initial effects cannot be sustained over time. Furthermore, although policies for restricting aggregate demand and readjusting relative prices are necessary for stabilizing prices in the long term, in the short term they may have recessionary effects unless they are accompanied by policies which rapidly bring the inflationary expectations into line with the target level of inflation established in the stabilization programmes. This is why stress must be laid on the need to combine policies which attack both the basic factors behind inflation --i.e., budgetary and structural problems-- and the factors responsible for the spread or inertia of inflation. Both could obviously be dealt with more easily if the external imbalance were reduced.

a) Controlling aggregate demand

As is well known, monetary and fiscal expansion, whether exogenous or endogenous, usually accompanies any inflationary process. Thus, regardless of whether the inflation was or was not originally due to excess demand, in general it is impossible to have an effective and lasting stabilization programme unless aggregate demand is brought under control.

With regard to the public finances, the danger that slowing down public sector demand will cause a recession depends not only on the size of the deficit to be reduced but also on the way in which it is reduced, i.e., on whether this is done by raising earnings or by cutting expenditure. If it is acknowledged that inflation is a kind of tax, tax neutrality dictates that tax revenue should be increased rather than reducing expenditure, unless the original cause of the spurt of inflation was a sudden rise in the ratio of public spending (excluding interest payments) to the gross domestic product. Moreover, as increase in tax revenue usually affects activities more evenly than does a cut in spending, thus increasing the likelihood that adjustment will take place more through the lowering of the rate of price increases than through a drop in production.<sup>37/</sup> On the other hand, if the cut in expenditure is confined to a few activities or if it affects investment more than current outlays, the reduction in aggregate demand will tend to slow production as well as inflation.

In any case, the fiscal effort need not be proportional to the deficit as measured in normal accounting practice. For example, if interest payments on the internal debt constitute a large share of public expenditure, higher inflation will increase the deficit, since much of the amount paid in interest will correspond to the accelerated amortization of the debt, so that the deficit, as measured in the accounts, will exaggerate the true degree of financial imbalance and the real pressure this exerts on prices.<sup>38/</sup> In contrast, slowing inflation automatically raises real taxes by reducing the amount of devaluation which takes place during the period between the time the income is generated or the law on the basis of which taxes are levied and the time when the tax in question is actually collected. This phenomenon is particularly important in very intensive inflationary processes, where the loss of purchasing power of taxes—even if only one month elapses before the taxes are collected—reaches high proportions. Thus, the amount by which the deficit can reasonably be reduced is smaller than might be thought at first sight.

Finally, if stabilization is to be of a lasting nature it must be effected without any significant lags in the relative prices of the key variables (exchange rate; prices of strategic tradeable goods; such as fuels, wages, interest rate), and must not be at the cost of sacrificing the normal or reasonable levels of public investment and social expenditure. If there are substantial lags, not only will the allocation of resources be ineffective but doubts will arise concerning the credibility of the stabilization programme, with the result that expectations will turn against it.

b) Inertial inflation and price and income policies

The dangers of a stabilization programme having recessionary effects are not proportional to the rate of inflation but tend instead to be commensurate with its persistence, for in cases of chronic inflation indexing mechanisms are created which, while they make the inflationary process tolerable, do so by notably strengthening its inertia, since they tend to keep the inflation at its past rates. For this reason, although a coherent integral stabilization programme which effectively solves the problems of conversion and financing may be designed and made public, nothing ensures that the authorities responsible for its implementation will be able to keep to their intentions in the future. The result of this is that even when private sector agents provide for a certain decline in inflation in their expectations, they always think the decline will be less than that postulated by the national authorities.

In these circumstances, even if all the agents believe that the government is going to keep up its programme at any cost, and even if in principle they are willing to keep their price rises down to the rate of inflation established as a target, they will not actually do so unless they are sure that the other economic agents—especially those which supply material inputs and labour—will take the same attitude, for if the agents slow down the growth rate of their prices without being sure that their costs will also be cut, they will be running the risk of reducing their profits. Faced with such uncertainty, the logical thing for an economic agent to do would be to reduce the growth rate of his prices, without however bringing

them down as far as the rate of inflation targeted in the stabilization programme. Since everybody will be thinking along the same lines, however, what is most likely to happen is that the general level of effective prices will be higher than the planned prices, with the result that sales, production and employment are likely to drop.

The justification for including policies to control prices and incomes and to promote de-indexing in inflation control programmes lies precisely in the need to prevent the recession to which this kind of behaviour gives rise, since such policies serve to harmonize or co-ordinate the expectations of the different economic agents and bring them into harmony with each other and with the macroeconomic policy. In this case, controlling, setting or freezing prices assures the individual economic agents that other prices, especially those of their suppliers, will move in line with the targeted rate of inflation and that their own prices will therefore not lag behind when readjusted on the basis of the targeted inflation. The justification for such a prices and incomes policy is therefore that it harmonizes and reconciles the behaviour of the economic agents, thereby preventing recession, rather than that it represses inflation. It is precisely for this reason that if price control policies are not accompanied by policies to control aggregate demand and correct relative prices, their effect on inflation will be short-lived or at best inadequate (to the extent that they help to prevent hyperinflation), since they attack the inertial component of inflation rather than those components which are associated with problems of conversion and the budget.

Attempts to apply programmes based on this approach have had ambivalent results. Argentina avoided hyperinflation, while Peru managed to slow down its inflation significantly for two years, and both countries did this without experiencing recession. The fact that the success of their programmes was only partial is due to the tremendous difficulty involved in gaining adequate control over aggregate demand. In extreme cases, the prices and incomes policy has in fact not been used to supplement the policy for controlling aggregate demand and correcting relative prices but merely as a substitute for it.

It should also be noted that in helping to lower inflation rapidly, these policies set in motion what might be called a "virtuous circle" since their initial satisfactory results strengthen confidence and credibility, which reduces the speculative demand for goods and foreign currency, raises the demand for money, and increases real tax revenue. This explains why it is relatively easy to go from a high inflationary situation to a low one. However, for similar reasons, the process can reverse and set up a vicious circle if it is not supplemented by the other policies mentioned above.

The greater the inertial component of inflation, the more important it will be to attack this problem of expectations; however, the array of instruments needed to back up a policy to control prices and incomes and promote de-indexing varies according to the degree of inflation. For example, in the case of hyperinflation, controlling a single price (that of the exchange rate) will be decisive for synchronizing the evolution of all the other prices, since in hyperinflationary situations they are all adjusted on the basis of the price of the dollar on the free market. On the other hand, in the case of inflation which is high but nevertheless does not amount to

hyperinflation (between 5% and 30% a month, as in Argentina, Brazil and Peru before the application of their respective stabilization plans), prices are usually readjusted on the basis of different indicators (the consumer price index, the interest rate, the unit cost of labour, the exchange rate), rather than on the basis of the price of the dollar on the free market alone. In such cases, therefore, a prices and incomes policy must anchor several prices in order to synchronize and harmonize their evolution with the targeted rate of inflation and thus prevent key prices from lagging and leading to the subsequent failure of the stabilization programme. In actual fact, the history of the region is full of examples of stabilization programmes which failed because they concentrated on gaining control of aggregate demand and of only one key price (the exchange rate or wages). If they were focused on the exchange rate, they failed because they produced a considerable exchange lag which eventually ended in crisis (Southern Cone countries, 1978-1982); if they focused on wages, they came to grief because they gave rise to a regressive and/or recessive wage lag (Argentina, 1976-1978; Chile, 1973-1975).

At all events, controls of this kind must be viewed as temporary instruments whose objective is to harmonize expectations by hastening the move towards equilibrium. Their duration should therefore be limited; if it is not, distortions will occur in relative prices which will be increasingly costly in terms of inefficiency in the allocation of resources and lack of credibility of the economic policy. Nevertheless, controls must be maintained long enough to make people confident that inflation will not return to its historical rate once prices are unfrozen. Thus, the essential thing is to erase the memory of the high inflation of the past lest the lower rates obtained through the programme be regarded as artificial.

#### c) Stabilization and adjustment

Finally, an important lesson to be learned from the experience of recent years, and one which is, moreover, borne out by the theoretical studies on the subject, is that an attempt to stabilize prices while at the same time adjusting the external accounts is extremely likely to bring on a recession. The reason for this is that while adjustment calls for real changes in the structure of production, which can only be achieved gradually, control over inflation calls only for changes in the nominal values of the variables, and in theory this can be effected suddenly and without causing a recession. Furthermore, while some policies, such as those for reducing aggregate demand, serve to further both adjustment and stabilization, other measures such as devaluation, while they do indeed help to promote adjustment, frequently tend to increase inflationary pressures, especially in the short term.

### F. GROWTH AND ECONOMIC INTEGRATION

In spite of the considerable heterogeneity of the countries and subregions which make up Latin America and the Caribbean, they face a number of common problems —especially those arising from the restrictions described above— which essentially concern the external sector. It is therefore only logical to look into the potential and real advantages of tackling these common problems

by means of joint action. This accounts for the major initiatives taken in the region as from the 1950s, both in order to share markets and to promote industrial specialization and complementation. It also fully justifies the fact that a number of countries have sought, through economic integration, new ways of responding to the challenges of the 1980s, as illustrated by the bilateral agreements mentioned earlier. However, the crisis has also acted against integration by posing new dilemmas in the field of economic policy in which the need to adjust conflicts with the commitments to grant intra-regional trade preferences.<sup>39/</sup>

There can be little doubt that economic integration and co-operation are capable of making a major contribution towards diminishing or mitigating the obstacles to growth and bolstering the efforts needed to return to the path of development. On previous occasions the Secretariat has put forward specific proposals on some possible lines of action in this respect.<sup>40/</sup> However, it is necessary to make some further observations regarding the opportunity cost of failing to take full advantage of those means and mechanisms in respect of which countries can take decisions much more freely.

Integration is striding towards its fourth decade of existence in Latin America and the Caribbean. Although the appraisals of this process vary to some extent, there is no denying that the overall balance is positive, as the countries of the region have travelled a difficult road in order to learn to work together, and they have tried out forms of co-operation and established permanent links, which, in some cases, are on an impressive scale. However, difficulties and shortcomings remain, among which mention should be made of the intangible but essential factor of the attitudes adopted towards the process. There has apparently been insufficient appreciation of the fact that integration and co-operation constitute a joint undertaking in which it is not possible merely to pursue short-term benefits, failing to give due regard to both the broad range of longer-term economic benefits and the responsibilities implicit in this process.

There has been and continues to be a pronounced tendency in the region to assess the efficacy of integration processes purely from the angle of trade, losing sight of the fact that the future of integration is intimately linked to political events and circumstances which determine the conduct of governments. Many of the crises which, in one way or another, have periodically affected the various programmes under way in Latin America and the Caribbean have sprung from deep changes in the nature and political orientations of governments. Thus, although it is perfectly feasible to take steps signifying progress in trade matters even between governments of different ideological persuasions, it is perhaps more difficult to pursue programmes involving more thorough-going co-operation between countries which do not share the same interests and values.

Moreover, this trade-biased view evaluates the benefits of integration within an extremely restricted framework of time and productive considerations. While any integration process basically seeks to further the economic benefits enjoyed by the enterprises involved therein, criteria of private profitability do not always take into account the full range of economic and technological stimuli and benefits which may be drawn from the process in the longer term by the productive apparatus as a whole. The

strategic view adopted by governments, however, can take such benefits into account, supporting and complementing trade concessions with compensatory measures, financial services, State purchase agreements or sectoral programmes involving a variety of instruments.

The stress which has been placed on the trade aspects of regional integration has also tended to magnify the importance of the criticisms levelled at the process, based on the failure to carry out legally binding commitments on account of circumstances arising from the restrictions described in previous chapters. Furthermore, this stress has restricted the possibility of enlisting the support of other social and economic forces and actors favourable towards integration. This is quite apart from the fact that a tariff concession can rapidly be cancelled out by fluctuations in the exchange rates or by the application of non-tariff measures, which have tended to proliferate both inside and outside the region.

Similarly, the economic crisis which has so severely affected the region has also left its mark on the subregional integration programmes, both by reducing the flows of trade within the programmes and by undermining the very foundations of their institutions. In the year which has just ended, however, there has nevertheless been a trend towards the reactivation of these programmes following a long period of virtual paralyzation of any substantive action by them.

Thus, the Andean Group, following a period of pronounced deterioration in its instruments and weakening of the links between its member countries, has adopted the Protocol Modifying the Cartagena Agreement and is now in a position to begin to resume a more active role in regional integration and co-operation bodies and at the same time to reactivate its own integration process.

The Latin American Integration Association (ALADI), for its part, through the Regional Round of Negotiations and following a prolonged period of study and analysis, is striving to set in motion a programme to expand and restore intra-zonal trade.

The Central American Common Market, which has been severely affected by the tensions caused by the economic and political situation of its member countries, sees hopeful signs of being able to return to normal circumstances, now that a formula has been found for solving the problems threatening peace. If this way out of the conflict materializes, it will undoubtedly give a powerful stimulus to the long-standing vocation of unity which prevails in Central America. Similarly, the Caribbean Community (CARICOM) is seeking a formula which will allow it to establish itself more firmly and consolidate its position as an integration body.

In this context, the role which the larger countries of the region should play in the present phase is quite clear. A gradual opening-up of their markets to the other countries would have a significant impact on regional trade, both because of their size and also because generally speaking they have the lowest indexes of economic relations with the other countries of Latin America and the Caribbean. Such an opening-up should make it possible to consolidate and expand the productive system of the main beneficiary

countries, as a result of which the regional integration and co-operation processes could gain renewed dynamism. It would also help to improve the level of competitiveness of activities traditionally oriented towards domestic markets, as a form of apprenticeship prior to their future exposure to the competitive conditions prevailing on world markets.

Undoubtedly integration, as an idea or objective, has received political support from governments and entrepreneurs. Frequently, however, such support has been merely rhetorical, so that it can be said that the process does not yet constitute a true political project for the countries of Latin America and the Caribbean. This observation no doubt underlay the declaration made by the Presidents of the Group of Eight countries making up the Permanent Mechanism for Political Consultation and Co-operation, who stated: "we are clearly aware of the urgent need to strengthen regional integration and co-operation, and to this end we are determined that they should form part of our national political projects....".<sup>41/</sup> This presidential statement is significant because it seems to point the way to reconciling in a harmonious and rational manner, the interests of each individual country and those of the integrated region.

Integration, as a political project of the countries of Latin America and the Caribbean, which has been incorporated into the national dimension of each one of them, involves the participation of a broad range of social actors, including the States themselves. While the latter have played an important role in diplomatic and economic affairs, they have been less active, for example, in utilizing the considerable purchasing power of State enterprises as an incentive for diversifying the productive apparatus and increasing mutual trade.

This political view of the integration process means, moreover, that the final objective is to create permanent economic and political links among the countries of Latin America and the Caribbean; thus, increased trade will be an indication of the achievement of greater degrees of interdependence, which will ensure that the trade flows in question will be more stable and predictable. The establishment of permanent links will be achieved by interlinking interests, harmonizing them and increasing the participation of all the social actors in the decisions affecting the process. The legal or economic form in which these new links might be generated and develop would thus be reinforced by a greater political commitment to the ends and objectives of integration.

If integration and co-operation are viewed in this way, it is possible to appreciate to the full the scale of the symbiotic relationship which exists between the strengthening of the links of co-operation and integration within Latin America and the Caribbean and the need for the region to organize its capacity for bargaining and dialogue and to exercise it in the international sphere so as to safeguard the region's interests. In the words of the eight Presidents quoted above: "integration constitutes an essential instrument for ensuring more effective participation of the region in international relations, by increasing its bargaining power with third parties".<sup>42/</sup> Such a task, based on what some have called the "new economic diplomacy" emerging in the region, can only be developed within the framework of a process of regional integration.

One of the aims underlying the present proposals put forward by Latin America and the Caribbean at international meetings concerns a qualitative change in the region's place in the world, precisely to lessen the vulnerability of their economies in respect of the external sector, to acquire the necessary autonomy in the formulation and implementation of their economic policies, and to diversify their productive systems. These objectives can hardly be attained, however, if the region itself fails to construct "from within" its bargaining power in the international arena, in order to make it felt in a constantly changing world.

An approach such as that proposed is a functional requisite for attaining sustained growth. It calls for the adoption of joint stands, at least on a number of topics of common interest, which may even be bolstered by the possibility of applying common treatment to third countries in respect of access to the regional markets. From another angle, a broader political and economic space is a fundamental requisite for endeavouring to bring about a qualitative change in the form of insertion of Latin America and the Caribbean in the international sphere. This change is only possible in so far as the productive apparatus is modernized and diversified: a task which will require saving and investment, as well as a joint and systematic effort to unite the capacity for research and technological development and to apply it to the production process. The challenge thrown down by the scientific and technical revolution which is under way in the industrialized countries is of such a scale that far greater human and financial resources are required than those which each country individually is capable of mobilizing.

Within the same line of thought, economic integration is also functional to the achievement of more equitable growth. By making fuller use of the broader space available it is possible to make investments --both public and private-- which help to increase employment; there are a variety of means of attaining this objective and some of them have already been utilized in the bilateral agreements recently signed, as well as in others which are under negotiation. This underscores the relevance of integration as a basic tool for achieving the central development objectives of the countries.

Bearing in mind the processes under way, the list of priorities in respect of regional integration and co-operation should focus, in the short term, on the following tasks:

a) Instituting a programme to reactivate and generate intra-regional trade flows, by promoting basic action aimed at:

i) Achieving determined political support for the efforts undertaken within ALADI to put into practice Resolution 15 of the Third Meeting of the Council of Ministers of Foreign Affairs of the ALADI Countries (March 1987) relating to the recovery and expansion of trade. This resolution seeks to redirect towards the regional market 30% of the imports from outside countries. It may be noted that up to November 1987 the lists of products imported from outside countries submitted in this connection totalled US\$12 billion, which shows the importance of this trade. The reorientation would be based on a tariff preference of approximately 60%, as well as on the elimination of non-tariff restrictions. Negotiations continue to be hampered,

however, by a number of technical problems, especially regarding the imbalances which might arise;

ii) Designing and promoting a new system of negotiations between the Andean Group and Argentina, Brazil and Mexico. Such a system should go beyond the conventional trade negotiations based on strict reciprocity, in order to progress towards sustained increases in the coefficients of purchase and supply with a view to attaining real regional interdependence;

iii) Setting up a framework for joint negotiations between Central America and the ALADI countries, for the purpose of generating new trade flows so as to help increase the utilization of installed capacity and establish operational links between the two groups of countries. Such trade co-operation with Central America should be considered as being complementary to the overall economic co-operation proposed below;

iv) Strengthening the as yet weak trade relations between the countries of ALADI and CARICOM.

b) Strengthening the subregional financial and payments systems. The minimum measures required in this respect include making the payments mechanisms more flexible, "dedollarizing" mutual trade and obtaining fresh foreign exchange in order to provide liquidity for the existing clearing and financing systems in general. Consideration could also be given to the establishment of a Latin American Reserve Fund, as well as of a Latin American External Trade Bank, taking into account the existence of the Latin American Export Bank (BLADEX). A number of agencies owned by public or private banks of the region in various industrialized countries could be integrated into the latter. The fundamental purpose would be to ensure that most of the financial and credit flows generated by transactions are carried out through the proposed bank. It should be capable—in terms of solvency and reliability—of attracting Latin American deposits abroad, including those corresponding to capital flight.

c) In the same line of ideas, consideration could be given to a number of measures that could aid the search for regional interdependence in the short term. For example, the Andean Development Corporation (CAF), the Central American Bank for Economic Integration (BCIE) and the Caribbean Development Bank could establish close links with LATINEQUIP, so as to channel a greater share of the increased investment in equipment necessary to expand and renew the industrial and service infrastructure towards the purchase of capital goods produced in the region, thereby multiplying the economic reactivation effect. Similarly, efforts could be made to incorporate locally-produced parts and components in the custom-made equipment purchased, in order to reduce the existing imbalances, as well as to sell them to the countries exporting goods to the region, so as to balance the trade even if only partially.

d) With regard to Central America, consideration should be given to the co-operation which the other countries of Latin America could provide in support of the domestic efforts of the countries of this subregion. Such co-operation could cover a number of aspects: in addition to the trade aspects already mentioned, external financial collaboration is vital. Opening up the

BCIE to new members has attracted several countries in the region, and this trend should be expanded and consolidated. In addition, there is a wide range of possibilities for promoting technical co-operation between the larger countries of the region and the countries of Central America.

e) Preparing, on the basis of mutual agreement, operational trade mechanisms —tariffs and non-tariff restrictions, for example— which make it possible to utilize the purchasing power of the region to improve the access of its export products to the principal international markets.

f) Taking advantage of the broader political and economic spaces created by integration in order to transform industrial activity and increase local technological capacity, especially in those branches which have fallen behind or where levels of consumption are very low. Enterprises in those countries which have attained a significant level of development in the region could provide effective and beneficial collaboration to firms in the less-developed countries in order to help them to incorporate technical progress into their manufacturing activities.

g) Undertaking co-operative projects in the fields of technological development and the training of key human resources in order to create the region's own technological capacity in sectors where this is feasible, but requires far greater capital and technical resources than those available to the individual countries.

h) Organizing a system of co-operation in agriculture and in respect of basic commodities so as to increase supply, guarantee rational levels of consumption and achieve the greatest possible degree of autonomy, especially with regard to international markets. As is well known, the latter are subject to serious distortions caused by the subsidy policies applied by the industrialized countries.

i) Simplifying and harmonizing the procedures applied to intra-regional trade and transport, especially international land transport, so that exporters and importers may benefit from the advantage that their geographical proximity should represent.

j) Finally, implementing a programme of co-operation in the services sector in order to unite national capacity and provide support for a joint stand in the negotiations under way as part of the Uruguay Round of GATT.

Action such as that described above could be carried out within a relatively short space of time, since it is based on existing studies and the measures in question have already been debated. However, it may be some time before its impact makes itself felt.

Moreover, Latin America and the Caribbean need to take international action at a number of levels. First, at that of the traditional common front with the other developing countries; secondly, by using their increased bargaining power to persuade the developed countries, both capitalist and socialist, to initiate a process of dialogue and negotiation relating to aspects of particular priority for the region, for which purpose it is necessary to agree upon an agenda of interest to both parties; and thirdly,

at the level of their relations with other groups of countries, developed or developing, without prejudice to the bilateral relationships which may exist between each of the countries in the region and the other members of the international community.

To sum up, what it is desired to emphasize is that taking a political view of the economic integration of Latin America and the Caribbean appears to be both useful and necessary in order to organize and exert credible and effective bargaining power in the international sphere. Credible, because the proposals put forward by the region would be backed up by its domestic efforts to achieve unity; efficient, because such unity would make it possible, whenever necessary, to apply to outside countries the same treatment as that given to countries of the region. Only greater regional identity and improved linkage of their interests will reduce the vulnerability of Latin America and the Caribbean in the face of external factors.

#### Notes

1/ See ECLAC, Latin American and Caribbean development: Obstacles, requirements and options, "Cuadernos de la CEPAL" series, No. 55, Santiago, Chile (LC/G.1440), June 1987, p. 9; and ECLAC, Crisis and development in Latin America and the Caribbean, LC/L.333(Sem.22/6)/Rev.1, Santiago, Chile, July 1985, pp. 1-7.

2/ Especially the document Latin American and Caribbean development: Obstacles, requirements and options, op. cit., prepared for the Special Conference of ECLAC held in Mexico City from 19 to 23 January 1987. The report of this Conference is given in document LC/G.1464.

3/ See, in this respect, Latin American and Caribbean Institute of Economic and Social Planning, La democracia y los desafíos para una nueva planificación, First Latin American Meeting on Planning and Public Management, Buenos Aires, Argentina, 23-26 September 1987.

4/ Seven countries still have not managed to return to the 1980 level of their product; the per capita product of the great majority of countries (fifteen) continues to be lower than the levels recorded in the early 1980s, and for some of them even the possibility of returning to that level by 1990 is becoming increasingly remote.

5/ If only the 1980 terms of trade of all the countries of the region had been maintained in 1986, the value of the exports of goods and services from Latin America and the Caribbean in that year would have been US\$33 billion greater than the amount actually recorded.

6/ Even though it must be pointed out that many of the countries of lesser economic size were not in a surplus situation on their trade accounts. Moreover, the situation was less dramatic in 1987 thanks to a recovery in the prices of some commodities, and particularly to a reduction in payments of interest on the external debt. The latter, in turn, is partly attributable to moratoriums, both unilateral and agreed. Even so, it is estimated that in that year the region as a whole transferred abroad a volume of financial resources equivalent to 2% of its gross domestic product, instead of receiving a net transfer of between 1% and 2%, as was the case in previous decades. See: ECLAC, Preliminary Overview of the Latin American and Caribbean Economy, 1987 (LC/G.1485), Santiago, Chile, December 1987.

7/ See: ECLAC, Economic Panorama of Latin America, 1987 (LC/G.1481), Santiago, Chile, September 1987, pp. 1-8.

8/ See: ECLAC, Crisis and development: the present situation and future prospects of Latin America and the Caribbean, Volume 1, (LC/L.332(Sem.22/3)), Santiago, Chile, April 1985.

9/ ECLAC, La dimensión de la pobreza en América Latina, "Cuadernos de la CEPAL" series, No. 27, Santiago, Chile, 1979.

10/ PREALC, Ajuste y deuda social, un enfoque estructural, Santiago, Chile, 1987.

11/ See: ECLAC, Recent economic developments in Latin America and the Caribbean (LC/L.422), Santiago, Chile, June 1987, pp. 50-53.

12/ See: ECLAC/UNIDO, "La crisis industrial de los ochenta", in Industrialización y desarrollo tecnológico, Informe No. 3 (LC/G.1442), Santiago, Chile, November, 1986.

13/ See: World Bank, World development Report, Washington, D.C., 1987; International Monetary Fund, World Economic Outlook, Washington, D.C., April 1987, and World Economic Outlook, advance copy, October 1987; Organization for Economic Co-operation and Development (OECD), Economic Outlook, Paris, June 1987.

14/ Joint Ministerial Committee of the Board of Governors of the Bank and Fund on the Transfer of Real Resources to Developing Countries, Market Prospects for Primary Commodities, Washington, D.C., March 1987, and World Bank, Price Prospects for Major Primary Commodities, Vol. 1, Washington, D.C., October 1986.

15/ For a more detailed explanation of the characteristics of this model, see: ECLAC, Modelo macroeconómico y del sector externo del Centro de Proyecciones Económicas (LC/R.526), Santiago, Chile, September 1986.

16/ The above assumptions coincide, in orders of magnitude, with the estimates prepared by most of the United Nations agencies and European countries that prepare prospective studies.

17/ If account is taken of the fact that, in the countries of the region in general, the 10% of the population with the highest incomes usually receives more than 40%, and in quite a few cases almost 50% of total income, it is easy to understand why, for example, in all cases growth has been accompanied by a heavy increase in demand for motor vehicles.

18/ Estimates prepared on the basis of preliminary figures for Argentina, Brazil, Chile, Colombia, Costa Rica, Mexico, Peru and Venezuela (covering all non-agricultural goods-producing sectors).

19/ See in this connection, for example, ECLAC, Agriculture, external trade and international co-operation (LC/G.1492), Santiago, Chile, January 1988.

20/ This subject has been dealt with in previous Secretariat documents. See, for example, ECLAC: Latin American and Caribbean Development ..., *op. cit.*, pp. 34-38.

21/ ECLAC, The evolution of the external debt problem in Latin America and the Caribbean (LC/G.1487), Santiago, Chile, December 1987.

22/ See in this respect, E. Lahera, La conversión de la deuda externa: antecedentes, evolución y perspectivas (LC/R.614), Santiago, Chile, ECLAC, September 1987.

23/ See ECLAC, The evolution of the external debt problem ..., *op. cit.*

24/ As the drafting of this document was being completed, Mexico announced the bases for a settlement. Under this, it offers to convert up to US\$20 billion of its medium- and long-term official debt owed to the banks

into up to US\$10 billion of 20-year bonds, without payment of installments of the principal but with regular payments of interest at 1.625% over LIBOR. The principal of these bonds would be guaranteed with up to US\$10 billion of U.S. Treasury Bonds, also with a term of 20 years but not bearing interest, which Mexico would purchase for cash at a current value equal to one-fifth of their nominal value. Other debtor countries were studying the possibility of making similar arrangements.

25/ See ECLAC, World technological change and its consequences for Latin America (LC/G.1493), Santiago, Chile, February 1988.

26/ These aspects were recently dealt with in ECLAC, Latin American and Caribbean development: obstacles, requirements and options, Santiago, Chile, "Cuadernos de la CEPAL" series, No. 55, 1987, in particular pp. 69-85.

27/ The clearest manifestations of this are to be found in the well-known phenomena --which have apparently become more marked in recent years-- of erosion, deforestation and desertification.

28/ This does not fail to take into account the fact that there are significant national and sectoral examples of "authentic" improvement of competitiveness (in contrast with what might be termed a "spurious" improvement) effectively based on an increase of productivity with the incorporation of technical progress.

29/ International experience indicates that those countries --like those of Latin America and the Caribbean-- which possess a rich endowment of natural resources can and perhaps must attain levels of excellence at the international level in specialized capital-goods sectors linked to the prospection for, extraction, processing and preparation of final products and by-products based on those resources. Both in this sector as well as in those "slots" of the chemical industry which it is sought to promote, it may be necessary to establish an effective programme of "protection during apprenticeship", distinct from the unlimited protectionism characteristic of the past.

30/ Non-tariff barriers, linguistic, logistical and cultural barriers, and the variety and demanding nature of specifications.

31/ See, for example, ECLAC, Latin America on the threshold of the 1980s (E/CEPAL/G.1106), Santiago, Chile, November 1979.

32/ See ECLAC, Latin American and Caribbean development: Obstacles, requirements and options, *op.cit.*, pp. 31 and 86-95.

33/ See ECLAC, The crisis of social development: challenges and possibilities (LC/L.413), Santiago, Chile, February 1987.

34/ See Humberto Petrei, El gasto público social y sus efectos distributivos, Serie Documentos ECIEL, N° 7, ECIEL, Rio de Janeiro, 1987. Public expenditure in the social sector includes expenditure on education, social security, health and housing.

35/ In this connection, see, for example, United Nations Children's Fund (UNICEF), Adjustment with a human face: Protecting the vulnerable and promoting growth, Oxford, England, Oxford University Press, 1987.

36/ The criteria used in establishing categories and individual policies for each type of producer are treated in detail in ECLAC, Economía campesina y agricultura empresarial, Siglo XXI, Mexico City, 1982.

37/ This would help to explain the comparative success achieved by Bolivia and Israel in bringing their inflation down in recent years, since 75% of the reduction in their deficit was achieved through increases in income.

38/ That this factor was explicitly accepted by the International Monetary Fund in the programme agreed to with the Government of Mexico in 1986 is shown by the fact that one of the criteria laid down in the programme for measuring the public sector's deficit is the exclusion of the effect of inflation on interest payments on the internal debt.

39/ See ECLAC, Recent economic developments in Latin America and the Caribbean, op.cit., pp. 50 to 54.

40/ ECLAC, Latin American and Caribbean Development: Obstacles..., op.cit., pp. 97 to 112.

41/ Acapulco Pledge to Peace, Development and Democracy, entered into by the Heads of State of Argentina, Brazil, Colombia, Mexico, Panama, Peru, Uruguay and Venezuela (Group of Eight). Acapulco, Mexico, November 1987, para. 47.

42/ Ibid.





