

**THE ECONOMIC EXPERIENCE OF THE LAST  
FIFTEEN YEARS. LATIN AMERICA AND  
THE CARIBBEAN, 1980-1995**



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## INTRODUCTION

The regional crisis which started at the beginning of the 1980s ushered in a complex period of disequilibria and adjustments. Most countries of the region felt impelled to undertake structural reforms with the aim of creating more stable economies which would form a more integral part of the international context, and would be capable of significant, sustained growth.

The changes in emphasis of economic policy, Governments' commitment to the aims of reform and the gradual stabilization of their economies coincided with favourable changes in international conditions, and external financing began once more to flow towards the countries of the region.

Previously discernible trends towards changes in production patterns began to take hold under this new economic order, and new movements of change began. The region is still in the throes of a profound and extremely important process of structural transformation. Its outcome cannot be foreseen –it will depend on the opportunities and risks presented by the process of change as it unfolds.

It seems an opportune moment, at this point, to try to draw up an account of the achievements and failures of this very complex and far-reaching process.<sup>1</sup> Such

an assessment should be based on an examination of the performance of the region's economies during the various phases they have passed through over the last fifteen years. Their past experience affects the way they currently function, and a description of it can show clearly both favourable and unfavourable combinations of policies and external and internal circumstances.

The present document summarizes the empirical evidence available to date. To the extent that the information allows, the purpose of the analysis is to examine performance from the perspective of the link between the macroeconomic background and microeconomic behaviour, with particular emphasis on the institutions that provide the regulatory framework in which microeconomic activity takes place, and on the characteristics of the factor markets to which companies have access.

The examination of economic performance and of the factors determining the processes of change focuses on three basic areas: i) processes of macroeconomic stabilization and growth; ii) saving and investment behaviour; and iii) characteristics of the restructuring of production and trends in technical progress.

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<sup>1</sup> This account is presented in the ECLAC document, *Strengthening development. The interplay of macro- and microeconomics* (LC/G.1898(SES.26/3)), Santiago, Chile, 1996.



## I. STABILITY AND GROWTH

Between 1978 and 1981, the region reaped the benefits of an improvement in its terms of trade and a generous supply of external credit from the private international banking system. These conditions enabled the region to implement expansionary economic policies which, in turn, made it possible for 11 countries to mark up average annual growth rates of over 4% (see table I.1). In most cases, however, these accomplishments were coupled with untenable balance-of-payments deficits; indeed, 15 countries had current-account deficits amounting to more than 4 points of GDP, and in 10 of these cases the deficits came to over 5 points (see table I.2).

The interruption of voluntary international capital inflows following Mexico's declaration of a moratorium on its debt payments in August 1982, rising international interest rates and deteriorating terms of trade catapulted the region into a drastic adjustment process aimed at generating a trade surplus large enough to cover the financial gap opened up by these events. Between 1982 and 1984, the region's GDP stagnated, fixed investment slipped by slightly more than 5 points of GDP, and the deficit on the balance-of-payments current account shrank from 3.7% of regional GDP in 1978-1981 to 2.1%. It should also be noted, however, that Mexico and Panama both adopted far-reaching adjustment measures and that Venezuela continued to post a surplus on its current account.

The extraordinary nature of the crisis of the 1980s was reflected in a simultaneous and sustained downturn in the region's main economic and social indicators. Not only did the region witness a drop in production or a sharp decrease in its growth rate. The employment situation took a turn for the worse and real wages declined, inflation heated up and became more widespread, and the external sector's problems deepened. The deteriorating macroeconomic situation was compounded by severe crises in the countries' financial systems which had been set off by a combination of economic recession, interest rate hikes, steep currency devaluations and numerous fiscal emergencies.

For all intents and purposes, the adjustment process lasted until 1990 and involved successive declines in per capita GDP, although there were some exceptions to this rule due to the specific conditions existing in certain countries. The region's investment coefficient fell steadily until finally hitting bottom in 1987, after which it slowly began to move back up. By 1994, this recovery had brought it to slightly under 22% of GDP, but this was still below the levels of the early 1980s.

The abundant supply of capital that began to flow into the region in 1991 gave it the financing it needed, within the framework of the structural reforms being pursued by a number of the countries, to reactivate its economies and quell inflation, but it also posed a number of

Table I.1  
**LATIN AMERICA AND THE CARIBBEAN (19 COUNTRIES): TOTAL GROSS  
 DOMESTIC PRODUCT**  
*(Variation between annual averages)*

	1978/ 1981	1982/ 1984	1985/ 1990	1991/ 1994
<b>Latin America and the Caribbean</b>	<b>4.2</b>	<b>-0.0</b>	<b>2.0</b>	<b>3.6</b>
Argentina	0.1	0.8	-0.9	7.6
Bolivia	0.4	-3.2	1.7	3.7
Brazil	4.1	1.0	2.8	2.3
Chile	7.2	-3.4	5.6	6.8
Colombia	4.9	2.2	4.7	4.0
Costa Rica	2.2	0.9	3.8	4.9
Ecuador	5.3	0.7	2.1	3.7
El Salvador	-4.1	-1.0	1.4	2.5
Guatemala	3.6	-2.0	2.3	4.0
Haiti	4.1	-0.8	0.2	-8.3
Honduras	5.1	0.5	3.2	3.3
Mexico	9.2	-0.5	1.6	2.6
Nicaragua	-7.3	0.7	-3.4	0.8
Panama	8.2	1.5	-0.4	6.9
Paraguay	10.5	-0.2	4.0	2.9
Peru	3.9	-2.6	-1.4	4.7
Dominican Republic	4.5	2.6	2.1	3.5
Uruguay	4.8	-5.5	3.3	4.7
Venezuela	-1.2	-2.7	2.4	3.0

Source: ECLAC, on the basis of figures from official sources and the International Monetary Fund (IMF).

Table I.2  
**LATIN AMERICA AND THE CARIBBEAN: THE DEFICIT ON THE BALANCE-OF-PAYMENTS  
 CURRENT ACCOUNT AS A PERCENTAGE OF GROSS DOMESTIC PRODUCT<sup>a,b</sup>**  
*(Percentages)*

	1978/ 1981	1982/ 1984	1985/ 1990	1991/ 1994 <sup>c</sup>
<b>Latin America and the Caribbean</b>	<b>3.7</b>	<b>2.1</b>	<b>1.2</b>	<b>2.8</b>
Argentina	0.8	2.2	1.3	2.5
Bolivia	9.2	8.7	12.5	9.3
Brazil	4.4	3.0	0.3	-0.2
Chile	9.3	9.3	4.5	2.9
Colombia	0.9	6.4	0.5	0.1
Costa Rica	13.4	9.5	8.4	5.6
Ecuador	7.5	4.4	6.0	4.2
El Salvador	4.3	6.0	5.5	4.6
Guatemala	4.1	3.7	4.4	5.1
Haiti	15.5	15.2	13.3	7.8
Honduras	10.5	9.2	8.4	11.1
Mexico	4.5	-1.0	1.0	6.8
Nicaragua	12.1	22.8	40.0	51.9
Panama	8.4	-1.7	-3.6	3.1
Paraguay	6.5	7.0	7.5	9.0
Peru	1.7	4.7	3.0	4.9
Dominican Republic	8.5	7.5	4.1	2.9
Uruguay	4.7	1.8	0.2	1.7
Venezuela	-0.1	-2.9	-1.7	-0.1

Source: ECLAC, on the basis of figures from official sources and the International Monetary Fund (IMF).

<sup>a</sup> Estimates of the gross domestic product (GDP) in current dollars were calculated on the basis of GDP data expressed in the local currency and the exchange rate applied to the relevant country's exports of goods and services.

<sup>b</sup> Negative figures refer to the ratio between a surplus on the balance-of-payments current account and GDP.

<sup>c</sup> Preliminary figures.

challenges in terms of the prevention of financial crises and the preservation of macroeconomic equilibrium and stability. Starting in 1992, an improvement began to be seen in those variables having the greatest significance within an international context: an appreciable increase in capital flows, a decline in external interest rates, a reduction in debt service, and a stabilization –and, in some cases, even an upturn– in the region's terms of trade.

In combination with the economic recovery and the stabilization of prices, the inflow of capital soon put an end to the external constraints affecting the region and, indeed, generated surplus funds. This situation was reflected in an upward trend in the value of the countries' currencies, the disappearance of the region's trade surplus from 1992 on, and a widening deficit on current account up to 1994 (see table I.2).

#### **A. THE LEVEL OF ECONOMIC ACTIVITY AND UTILIZATION OF PRODUCTION CAPACITY**

The costly external adjustment made by the Latin American and Caribbean countries during the 1980s was not only associated with a steep reduction in the flow of overseas financing but was also marked by the need to take wide-ranging measures in a very short period of time within an adverse trade environment, all of which meant that drastic cuts had to be made in domestic spending. This situation was further exacerbated by the fact that the countries actually "overadjusted" in an effort to cope with the procyclical behaviour of international commercial banks as a whole and, in some cases, as a means of countering capital flight (ECLAC, 1984).

Output fell more sharply than appeared to be necessary, given the extent of existing external constraints. The sudden curtailment of external borrowing and the types of adjustment policies chosen in most cases limited the region's

growth potential. This made it necessary to make even deeper cuts in expenditure and generated recessionary conditions that heightened the underutilization of resources and the disincentives for investment.

The period 1981-1983 marked the height of this overadjustment, which prompted an even steeper downturn in domestic demand than in GDP, a sharp decrease in investment and a trade surplus that was primarily attributable to a drop in imports rather than to an increase in exports. This situation changed to some degree in the period 1984-1987, during which GDP and domestic demand strengthened, the region's external trade performance improved, and investment exhibited a slight upswing. This economic buoyancy was short-lived, however, since, despite improvements in both exports and imports, in 1988-1990 investment slackened once again and both GDP and domestic demand came to a standstill (see table I.3).

The region's economic showing for 1991-1994 stands out in sharp contrast to its performance in earlier years. GDP expanded at an annual rate of 3.6% and domestic demand grew by 4.4%, fixed investment climbed by over 8% per year and exports rose steadily, although much more slowly than imports did.

In the course of the adjustment process of the 1980s and the subsequent economic recovery, the various countries exhibited marked differences from one another. These differences were primarily a function of how large the individual countries' debts and trade imbalances were at the time that the external debt crisis began, the changes seen in their terms of trade, the amount of financing they received during the adjustment and the size of their public sector's external deficit.

The countries that were the first to resume the process of capital formation in the 1980s were those which had the least serious imbalances and were therefore able to use gradual policies (such as Colombia) and those which had access to

Table I.3  
**LATIN AMERICA AND THE CARIBBEAN: AGGREGATE DEMAND  
 AND THE LEVEL OF ECONOMIC ACTIVITY 1981-1994**  
*(Variation between annual averages)*

	Domestic demand	GDP	Export of goods and services	Imports of goods and services	Gross fixed capital formation
1981-1983	-3.2	-1.0	5.6	-12.9	-10.6
1984-1987	3.4	3.3	4.0	4.9	3.3
1988-1990	0.4	0.6	6.4	6.4	-1.9
1981-1990	0.5	1.2	5.2	0.0	-2.4
1991-1994	4.4	3.6	6.6	14.1	8.3

Source: ECLAC, on the basis of official figures.

external financing (such as Chile and Costa Rica). These three countries were better able to cope with their external shortfalls, which contributed to their domestic stability and growth and helped to raise expectations and investment levels by allaying uncertainty.

In 1991-1994, only Chile, Costa Rica and El Salvador had fixed investment coefficients that were close to or higher than their 1978-1981 levels. At the other end of the spectrum, Brazil's, Ecuador's and Venezuela's investment coefficients for the same period were even lower than they had been at the height of the crisis (see table II.4).

In sum, the region's economic performance during the period 1982-1990 placed it far behind its production frontier, with its actual output being much lower than its potential output; this situation was characterized by a severe underutilization of production resources and, in the presence of a marked degree of instability, a sharp downturn in investment which imposed constraints on future GDP growth. The upshot of all this was a slow pace of growth, a decrease in per capita GDP and listless

domestic demand up to 1990.<sup>2</sup> Consequently, what stimulus there was for increased productivity and technological innovation came chiefly from the competitive pressures that were generated by trade liberalization and were then heightened by the prevailing environment of sluggish economic activity and instability, all of which offset the positive effects of the region's generally high real exchange rates.

Between 1991 and 1994, on the other hand, both production and domestic demand picked up, and this helped to buoy the labour market and wage levels. An increase in investment was spurred on by the change in the region's macroeconomic environment and was further bolstered by the capital inflows that helped to finance its deficit on current account, which continued to widen until 1994.

The inflow of capital put an end to the external constraints affecting the region and helped fuel the recovery of production, income and employment, all of which made for a fuller use of production capacity. What is more, inflation slowed considerably and the

<sup>2</sup> The countries members of the Organization of Eastern Caribbean States were a notable exception, since they achieved rates of growth exceeding 5% on average throughout the 1980s. Preferential access for these countries, which expanded banana exports to the European market and rapid growth in their tourism sectors were major factors in producing this strong economic performance.

Table I.4  
**LATIN AMERICA AND THE CARIBBEAN (32 COUNTRIES): ECONOMIC GROWTH  
 RATES IN THE 1990s**

(Variation between annual averages for GDP in 1991-1995)

<b>Over 5%</b>	
Chile	7.0
Guyana	6.4
Argentina	5.6
Peru	5.4
El Salvador	5.3
<b>4%-5%</b>	
Belize	4.8 <sup>a</sup>
Panama	4.7
Costa Rica	4.4
Colombia	4.2
Guatemala	4.0
<b>3%-4%</b>	
Saint Kitts and Nevis	3.8
Saint Lucia, Dominican Republic	3.7
Bolivia, Antigua and Barbuda	3.6
Ecuador, Uruguay	3.4
Honduras	3.3
Paraguay, Saint Vincent and the Grenadines	3.0
<b>1%-3%</b>	
Venezuela	2.8
Brazil	2.6
Dominica, Jamaica	1.5
Grenada	1.4
Trinidad and Tobago	1.0
<b>Under 1%</b>	
Suriname	0.9
Mexico	0.6
Bahamas	0.3
Barbados	-0.6
Haiti	-6.0
Cuba	-7.0

Source: ECLAC, on the basis of official figures. The data for 1995 were taken from ECLAC, *Preliminary Overview of the Economy of Latin America and the Caribbean, 1995* (LC/G.1892-P), Santiago, Chile, December 1995. United Nations publication, Sales, No. E.95.II.G.18.

<sup>a</sup> Corresponds to the period 1991-1994.

public sector had either a surplus or a small, manageable deficit. These conditions allowed the region's economies to regain some of their growth capacity as their stability increased and external constraints subsided.

In the production sector, investment and productivity both rebounded,

especially in manufacturing. The combination of lower inflation and a resurgence of economic activity narrowed the gap between the region's actual and potential levels of output. This phenomenon, whether a product of the economic cycle or of the stabilization process, boosted productivity and has

enabled the countries to deal with revaluations of their currencies which, under other circumstances, would have had done more serious harm to their competitive positions. This upward trend in productivity does have a transitory component, however, and as the region moves closer to its production frontier this component should be replaced by more permanent stimuli that operate more independently of the economic cycle.

An analysis of trends in per capita GDP over the past 15 years reveals appreciable differences from one country to the next (see figure I.1). In 1995, this indicator was above its 1980 level in only nine of the countries (the nine that were closest to their own production frontiers) and exceeded that level by more than 10% only in Chile, Colombia, Uruguay, Jamaica and the Dominican Republic.<sup>3</sup> In contrast, per capita GDP fell steadily in Haiti from 1981 on and in Nicaragua from 1984 onward; fortunately, however, this downward trend was interrupted in 1995. In both cases this was due to a strong export performance in which favourable international prices were a contributing factor (see table I.4).

This dissimilarity arises out of the differences in the course taken by the process of adjustment, recovery and growth in the various countries. In 1983-1985, practically all the countries in the region underwent recessions. At least 10 of them experienced another production slump between 1988 and 1990, and a like number (including some of the same ones) found themselves in a similar situation once again in the early 1990s. Hence, in many cases the recovery has been a weak or hesitant one, while the present stage has begun so recently that its

macroeconomic and productive features are not yet clearly defined.

In Colombia, Chile and Jamaica, the downturn in per capita GDP was more fleeting than in the other countries, lasting only two years (1982 and 1983) in the first two cases and three years in the third. The fact that, together with the Dominican Republic and Uruguay, these countries have registered the largest cumulative increases in per capita GDP suggests that their efficient, timely response to the challenges of adjustment and stabilization has played a crucial role in their achievement of sustained growth (see figure I.1).

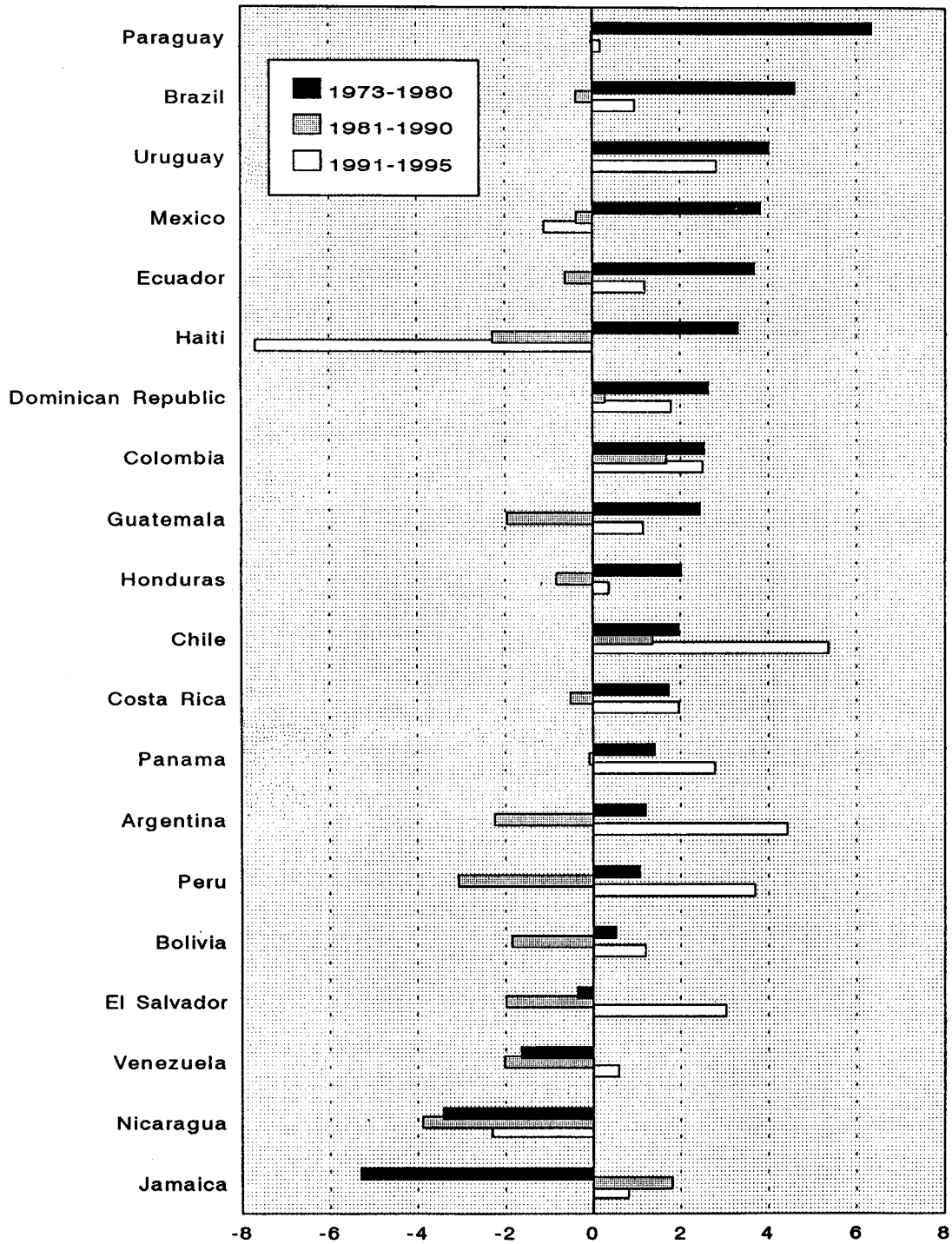
As of 1995, the countries in which the growth cycle for GDP had lasted the longest were Chile and Colombia (12 years), followed by Guatemala (nine years in a row).<sup>4</sup> The average annual increase in per capita GDP during these growth cycles has been quite high in Chile (an annual rate of 4.5%), somewhat lower in Colombia (2.6%) and much lower in Guatemala (0.9%).

The situation that arose in Mexico at the close of 1994 underscored just how important it is for key macroeconomic variables to reflect a situation of equilibrium in a country's money and product markets over the medium term and for external savings to provide a constant supply of resources. Defying the projections, in 1995 Latin America and the Caribbean were able to weather what could have turned into a major crisis, with only Argentina, Mexico and Uruguay experiencing an interruption of growth. The episode was a highly instructive one for the entire region, however. A majority of the countries continued to have mid-range growth rates, moderate and declining rates of inflation, a large deficit on current account which they financed

<sup>3</sup> In 1994, eight countries had a per capita GDP that was equal to or higher than what it had been in 1980. In 1995, Argentina's per capita GDP slipped back below this level while Paraguay and Barbados joined the group of countries in which this indicator was higher than in 1980.

<sup>4</sup> In 1994, Jamaica rounded out eight years of steady growth in per capita GDP at an average annual rate of 3.6% and Uruguay marked its seventh year of growth with an average annual increase in this variable of 2.4%. Both countries registered a decline in 1995, however.

Figure I.1  
**LATIN AMERICA AND THE CARIBBEAN: PER CAPITA GROSS DOMESTIC PRODUCT**  
*(Variation between annual averages)<sup>a</sup>*



Source: ECLAC, on the basis of official figures expressed in dollars at 1980 prices.  
 a Countries are listed in descending order according to their rate for the period 1973-1980. The growth rates shown here may not match those published by the countries because their gross domestic products were calculated on the basis of the 1980 price structure.

with external capital, and low national saving coefficients.

Chile stands apart from this general trend and appears to be consolidating a pattern of rapid and sustained growth together with a progressive reduction in inflation and high domestic saving rates. In addition, it has marked up an overall surplus in its fiscal accounts for six years running. Striking progress in the area of price stabilization has also been made by Brazil as it joins other countries in undertaking structural reforms.

In the period 1991-1995, five countries had growth rates of over 5% per year (Chile, Guyana, Argentina, Peru and El Salvador) and another five had rates of between 4% and 5% (Belize, Panama, Costa Rica, Colombia and Guatemala). A larger group of countries (10 in all) had growth rates of between 3% and 4%, but in six others per capita GDP was only from 1% to 3% and another six registered an outright deterioration in this indicator (see table I.4).

## B. INFLATION AND STABILIZATION POLICIES

After having experienced a strong surge in inflation due to the imbalances and adjustments that followed in the wake of the crisis that swept over the region in 1982, most of the economies have witnessed a downward trend—in some cases a very steep one—in their inflation rates. Nevertheless, there are still some cases in which this trend has not emerged or in which there is some doubt as to the permanence of the price stability that has been achieved.

In the medium term, consideration should be given to the possibility of reducing the countries' inflation rates as part of a broader change in the existing macroeconomic framework, taking into account certain factors that

play a role in determining the success of stabilization efforts. In table I.5, a total of 19 countries<sup>5</sup> are classified on the basis of the trends of some of their key macroeconomic indicators during the period when they were in the process of regaining their former levels of economic activity and carrying forward structural reforms (1986-1990) as well as during the period 1991-1994.

In the late 1980s the public sector's deficit shrank in a number of countries; in many others, however, no clear-cut downward trend was to be seen. Only one country, Chile, consistently recorded a surplus. In the early 1990s, an improvement in the fiscal situation became evident; in fact, most of the countries either had a surplus or a dwindling or stable deficit; there were four cases, however (Brazil, Costa Rica, Uruguay and Venezuela), in which the situation took a turn for the worse.

The expansion of the money supply has also contributed to price stability in recent years; the number of cases in which the money supply was on the rise diminished between the late 1980s and early 1990s, and most of the countries have since seen a reduction in this variable. At the same time, the outlook regarding the trend in the real exchange rates relevant to the countries' export performance underwent a radical change: whereas, during the first period, a majority of the countries had a rising or fluctuating exchange rate, during the second of these periods most of the countries' exchange rates were stable or their currencies appreciated in real terms, whether as a method of backstopping these countries' stabilization programmes or as a consequence of a mounting inflow of capital.

A positive change in gross fixed investment as a percentage of GDP is also to be observed between these two periods, and this change both reflects and has

5 These countries are: Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Jamaica, Mexico, Nicaragua, Panama, Paraguay, Peru, Uruguay and Venezuela.

Table I.5  
**LATIN AMERICA AND THE CARIBBEAN: TRENDS IN SELECTED MACROECONOMIC  
 VARIABLES IN 1990 AND 1994**  
*(Number of countries)*

Trend	Public-sector deficit	Public-sector surplus	Growth of money supply (M1)	Gross fixed investment/GDP	Real exchange rate for exports	Real average wages	Urban unemployment
<b>Upward</b>							
1986-1990	-	1	8	5	7	3	7
1991-1994	4	2	4	8	4	11	3
<b>Downward</b>							
1986-1990	6	-	6	7	4	7	5
1991-1994	4	1	10	1	5	1	3
<b>Stable</b>							
1986-1990	-	-	-	1	-	3	1
1991-1994	3	1	1	8	6	3	9
<b>Variable</b>							
1986-1990	11	-	3	5	6	2	4
1991-1994	3	-	1	1	2	-	3

Source: ECLAC, on the basis of official figures.

contributed to the consolidation of the stabilization process. Although in a number of cases the upswing in this indicator started off from very low levels due to the adjustments and instability of the 1980s, the climbing or stable investment rates registered in most of the countries during the 1990s—in contrast to the declining rates and fluctuations of earlier periods—are certainly a positive development since, as is well known, this is one of the factors that plays a crucial role in determining the long-term success of stabilization processes.<sup>6</sup>

The labour market also underwent some beneficial changes between these two periods, most of which were associated with the economic reactivation. First of all, in most cases upturns were seen in indexes of average real wage levels, although the intensity of those trends varied substantially from one

country to another; nevertheless, in a number of countries these indexes have not yet recovered from the real decrease registered in the 1980s. Second, in most cases the upward climb of urban unemployment levels was interrupted during 1991-1994, although it started up again in some countries in 1995 due to outbreaks of instability or the effects of stabilization programmes undertaken in response to the impact of the Mexican crisis.

In summary, a comparison of the conditions existing in the early 1990s and in the second half of the 1980s reveals a number of important changes in the macroeconomic environment: a moderate rise in the level of economic activity, a less deficit-prone public sector, a slower expansion of the money supply, a recovery in investment rates and a drop in unemployment. Moreover, real exchange

<sup>6</sup> Generally speaking, the faster growing countries have low inflation and high rates of investment in relation to GDP. Due to the uncertainty and price instability which it causes, inflation adversely affects investment and its efficiency and hence limits a country's growth potential (De Gregorio, 1995b).

Table I.6  
**LATIN AMERICA AND THE CARIBBEAN (14 COUNTRIES): INDICATORS OF  
 MACROECONOMIC STABILITY**  
*(1992-1994 average)*

Country	Con- sumer prices (Decem- ber- varia- tion)	Central govern- ment deficit (-) or surplus (+) (% of GDP)	Balance on current account of balance of payments (% of GDP)	Cumulative external debt/ exports of goods and services (1994)	Trade balance (% of GDP)	Competi- tiveness of real exchange rate, 1994 (1990=100)	Total interest on external debt/ exports of goods and services	Domes- tic saving/ GDP
Argentina	9.7	-0.2	-3.1	404.0	-1.9	78.0	16.3	16.4
Brazil	1 522.5	-1.0	0.7	308.0	2.9	91.0	16.8	22.9
Chile	11.2	1.9	-2.7	152.0	-0.4	96.5	8.5	24.7
Colombia	23.4	1.0	-2.2	179.0	-2.6	75.3	13.1	16.7
Costa Rica	15.3	-3.6	-6.6	110.3	-5.8	101.3	6.4	15.8
El Salvador	13.7	-3.6	-4.6	232.8	-15.3	82.8	7.0	13.4
Guatemala	12.5	-1.2	-6.5	100.8	-9.1	84.6	5.6	9.2
Honduras	21.4	-6.5	-11.8	266.2	-4.4	125.3	18.0	13.4
Mexico	9.0	1.7	-7.3	271.0	-5.0	82.1	24.0	17.5
Nicaragua	11.8	-8.5	-51.0	2 992.0	-27.2	103.8	103.9	-9.5
Panama	1.3	-0.9	-2.4	182.0	0.8	100.0	0.0	34.0
Peru	37.2	-0.3	-5.4	415.0	-3.2	87.2	21.2	18.6
Dominican Republic	7.9	0.3	-3.4	184.7	-5.7	96.2	7.5	18.5
Venezuela	49.5	-4.5	-0.8	223.0	2.2	94.2	15.9	19.8

Source: ECLAC, *Economic Survey of Latin America and the Caribbean*, Santiago, Chile (various years); International Monetary Fund (IMF), *International Financial Statistics*, Washington, D.C. (various years); and ECLAC, *Characteristics of the Central American Isthmus and the Dominican Republic which might affect their participation in the Free Trade Area of the Americas (FTAA) (LC/R.1584)*, Mexico City, ECLAC subregional headquarters in Mexico, November 1995.

rates rose more slowly than they had at the height of the adjustment process, partly because of the greater inflow of capital to the region; in fact, in those countries that opted for stabilization policies based on a greater use of available external resources, an actual appreciation of the currency was observed (see table I.6).

In an international financial environment that was conducive to suitable mixes of finance and adjustment policies for dealing with internal and external disturbances, the above-mentioned changes and the reforms that brought them about caused inflation to abate in most cases. Indeed, in the early 1990s an increasing number of countries had inflation rates of around 10% or less, in striking contrast to the situation in earlier years.

As shown in table I.7, in 1985-1990 only two countries had single-digit inflation, but in 1994 there were six countries in that position. The number of countries with moderate inflation rates (15%-25%) also climbed from four in the first period to seven in the second, and the number of countries with annual rates of over 25% fell to six. Brazil was the most conspicuous exception, in that it continued to register a high rate of inflation until 1994, when it adopted a stabilization programme that places special importance on cutting the public-sector deficit—a factor that has been demonstrated at both the regional and world levels to play a decisive role in determining the success of these types of programmes.

Although it is difficult to draw generally applicable conclusions

Table I.7  
**LATIN AMERICA AND THE CARIBBEAN (19 COUNTRIES): ANNUAL INFLATION RATES**  
*(December-December variations in the consumer price index)*

	1978-1981	1982-1984	1985-1990	1991-1994	1990	1994	1995 <sup>a</sup>
Argentina	132.1	443.5	1 216.2	28.2	1 343.9	3.7	1.8
Bolivia	27.0	934.1	1 383.9	10.7	18.0	8.5	10.7
Brazil	76.8	162.5	855.6	1 260.8	1 584.6	929.3	22.0
Chile	26.1	36.6	17.6	17.8	27.3	8.9	8.2
Colombia	27.5	22.4	21.1	13.1	32.4	22.6	20.0
Costa Rica	25.4	19.6	25.7	24.3	27.3	19.9	24.9
Ecuador	13.3	34.0	45.6	41.4	49.3	25.4	22.2
El Salvador	14.9	13.0	23.8	12.7	19.3	8.9	11.4
Guatemala	10.2	6.9	25.1	11.9	59.6	11.6	8.6
Haiti	13.2	7.2	7.9	19.1	26.1	52.1	25.0
Honduras	12.2	6.1	10.8	17.5	36.4	28.8	26.5
Mexico	23.7	79.6	71.7	11.5	29.9	7.1	48.5
Nicaragua	30.7	34.1	8 526.0	202.7	13 490.2	12.4	11.0
Panama	8.6	2.2	0.4	1.3	0.8	1.4	1.3
Paraguay	19.1	16.0	28.1	17.1	44.1	18.3	10.4
Peru	68.2	103.2	2 080.5	62.7	7 649.6	15.3	10.3
Dominican Republic	9.8	17.7	37.6	7.5	79.9	14.3	12.0
Uruguay	50.3	46.0	83.0	59.3	129.0	44.1	36.8
Venezuela	14.6	10.9	35.5	44.9	36.5	70.9	52.9

Source: ECLAC, on the basis of figures on consumer prices provided by official sources in the countries.

<sup>a</sup> From November to November.

regarding policy options based on events in the countries that have managed to reduce their inflation rates –partly because there is more than just one possible policy mix and implementation sequence– it is unanimously acknowledged that the public sector's medium-term financial situation should be a balanced one that offers a solid foundation for stabilization programmes. Suppressing inertial inflation and guiding expectations undoubtedly facilitate the implementation of programmes of this type, but the achievement of such objectives increasingly hinges upon a country's success in putting its public-sector budget on a sound footing, which strongly influences economic agents' expectations regarding inflation.

As noted earlier, the use of a real appreciation of the currency and of external financing as tools for controlling inflation have contributed to the stabilization process in some countries. The use of "nominal anchors" is important

in any stabilization effort, especially in the wake of episodes of hyperinflation and capital flight. Observation of events as they actually unfold tells us that this device yields much better results when applied as part of a package of measures designed to lower inflation over the long term. Among such measures, a lasting improvement in the fiscal situation and the elimination of problems of insolvency in the public and private financial system have been shown to be essential for the sustained success of stabilization policies.

The advisability of using a real appreciation of the currency as a tool to combat inflation also depends upon the structure of the expenditures that are covered with external finance. One of the most important lessons learned from the debt crisis is that a sudden upsurge in the supply of external funds generally leads to an unsustainable increase in consumption.

The only way to prevent this from happening is to channel a larger proportion of the available financial

## Box I.1

## CENTRAL AMERICA: CONSOLIDATING ITS STABILIZATION

In comparison to where they stood during the 1980s, in the 1990s the Central American countries have made a great deal of headway in stabilizing their economies; these advances have yet to be consolidated, however, and their economic reactivation has been quite uneven. Some countries still have large fiscal shortfalls that are reflected in high current-account deficits. Although it is clear that the Central American economies will be resorting to the use of external savings for a long time to come, the extent to which this is occurring at the present time is excessive. The practice of using volatile capital to cover their deficits heightens the fragility of their economies, and this may hinder the continued development of the subregional integration process.

The mean rate of inflation for the six countries of the Central American isthmus has declined considerably, thanks to their adoption of substantive fiscal measures within the broader framework of stabilization and adjustment policies, many of which have been implemented under the terms of agreements signed with the International Monetary Fund and the World Bank and with the support of the United States Agency for International Development. These agreements have contributed to a gradual convergence of economic policy objectives, although, except in the case of inflation, their implementation has yielded differing results.

In the early 1990s, Costa Rica, El Salvador and Honduras fully liberalized their

currency markets (although these countries' central banks may still step into the market in order to ward off excessive short-term fluctuations) while Guatemala and Nicaragua carried out partial liberalizations using an auction-based system in the first case and a crawling peg in the second. The liberalization of the countries' financial markets, and especially the decontrol of interest rates, forms part of the new direction taken by economic policy in this subregion. The resulting upswing in interest rates and the spread between them and international rates, adjusted for exchange-rate expectations, have sparked an inflow of external capital, and this has strengthened the interrelationship among such inflows, conditions in the subregion's financial markets and the level of the exchange rate. On the other hand, the increase in interest rates has discouraged capital-deepening investment and has added to the public-sector deficit.

Hence, the effects of the steps taken to cut the primary fiscal deficit have been counteracted by the increase in the cost of domestic debt caused by the practice of issuing high-yield securities in order to cover the public sector's deficit or to regulate the economy's liquidity. As a result, the quasi-fiscal deficits of Costa Rica, Guatemala and Nicaragua have reached considerable proportions, and the central banks of each of these countries have sustained annual losses equivalent to more than 1% of GDP.

Source: ECLAC, *El regionalismo abierto en América Central. El desafío de profundizar y ampliar la integración* (LC/MEX/L.261), Mexico City, ECLAC subregional headquarters in Mexico, April 1995.

resources into real investment so that they will bolster the economy's future payment capacity; otherwise, the stabilization will inevitably be a temporary phenomenon. As noted previously, the investment coefficients of the countries of the region have risen, but in some cases the flow of external resources has fueled a rapid expansion

of consumption, which was heavily repressed during the region's protracted periods of adjustment. In such a context, tax policy plays a highly important role because of its ability to prod investment into expanding more rapidly than consumption; financial policy can also make a valuable contribution by developing

instruments for channeling more external resources into investment.

The objective of a stabilization policy is to hold inflation down to a low, credible rate that can be maintained over the long term. In order to accomplish this while liberalizing the trading and financial systems, the sectors producing exports and tradable goods must have reached a sufficient level of development, diversification and flexibility. Therefore, in order for the stabilization process to be consolidated, it is important that the incentives provided for this sector should be consistent in nature.

In the short run, a difficult choice must be made between using a real appreciation of the currency to clamp down on inflation and developing export and goods-producing sectors capable of competing with imports. In the long run, an economy's stability depends to a large extent on the growth of these sectors, and it is therefore better to avoid any sharp real revaluations that might hinder the processes involved in achieving sustained increases in their productivity. One possibility, if the situation in the country justifies it, would be a gradual reduction of inflation in conjunction with the use of appropriate tools to control the entry of external resources and their impacts in terms of the real exchange rate and increased consumption.

### C. THE SHORTAGE OF EXTERNAL FINANCING AND CAPITAL FLOWS

As a consequence of a complex mix of external and internal factors, in 1982 most of the Latin American and Caribbean countries were overcome by the deepest and longest economic recession to hit the region in the last 50 years. Although external forces did help trigger the crisis, inconsistencies in internal economic

policies –e.g., overborrowing from external lenders, an excessive expansion of domestic spending, the implementation of stabilization policies based on exchange-rate lags and methods of financial liberalization that had the effect of keeping real interest rates at very high levels for long periods of time– were also at fault (ECLAC, 1984).

The trends observed in the flow of external finance since the debt crisis can be divided into two clearly distinct periods based on the direction of flow of net resource transfers and how this has influenced the region's economic performance. The first of these periods covers the years from 1982 to 1990; this period was a time of adjustment for the region during which it sustained a negative resource transfer equivalent to 3.2% of GDP. The second period, from 1991 to 1994, saw a recovery based on external saving; during this period the countries received a positive net transfer equivalent to 1.5% of GDP.<sup>7</sup> In this second period, the countries' external debt indicators exhibited a marked decrease (see table I.8).

The region's current account balance took on great importance in 1982-1990 as a result of the international credit squeeze. Because they had to pay out such large sums in the form of interest and profit remittances, which caused them to run up deficits on their financial services accounts, the countries had to build up sizeable trade surpluses, and in order to do so they had to maintain high real exchange rates and to keep them above their long-term values. In the 1990s, once the external financing gap had narrowed, this objective's place was taken by the financing of the balance of payments, which meant that the countries needed to take in capital in order to cover their growing deficits on current account. Thus, except in a few cases, the real exchange rate ceased to be used as a prime tool of economic policy and came to be

<sup>7</sup> These regional averages do not provide a true picture of the situation in Central America, which continued to receive a net inflow of external resources during the 1980s for what were, in large part, geopolitical reasons (specifically, the military conflicts in the subregion).

Table I.8  
LATIN AMERICA AND THE CARIBBEAN: THE EXTERNAL  
SECTOR 1978-1995

	1978- 1981	1982- 1984	1985- 1990	1991- 1995
Trade balance <sup>a</sup>	-1.5	2.9	2.7	-0.8
Balance on current account <sup>a</sup>	-3.7	-2.1	-1.2	-2.1
Ratio between net resource transfers (NRT) and exports <sup>b</sup>	16.7	-24.9	-20.7	7.5
NRT/GDP	2.1	-3.8	-3.1	1.0
Interest/ exports <sup>c</sup>	23.8	41.0	31.5	18.4
External debt/ exports <sup>d</sup>	235.2	327.3	348.0	259.5

Source: ECLAC, on the basis of official figures. The figures shown for 1995 are preliminary; the data on resource transfers do not include special balance-of-payments financing.

<sup>a</sup> As a percentage of GDP.

<sup>b</sup> Net resource transfers expressed as a percentage of exports of goods and services. The NRT corresponds to net capital inflows minus net payments of profits and interest.

<sup>c</sup> Total interest due and payable as a percentage of exports of goods and services.

<sup>d</sup> Total disbursed external debt as a percentage of exports of goods and services.

determined by the volume of capital flows.

The new international strategy for managing the Latin American and Caribbean countries' external debt within the framework provided by the Brady Plan made it possible for the countries to eliminate the arrears on their external public debts. Furthermore, they were gradually winning back investors' confidence, thanks to the fact that around the same time they were adopting credible fiscal adjustment measures and institutional reforms that attested to the strength of the Latin American and Caribbean Governments' commitment to the new economic order and, above all, to the idea of assigning a leading role to private investment.

Given these circumstances, together with a sizeable reduction in international

interest rates, foreign investors' attention was drawn to the high rates of return that could be obtained in economies that were in the midst of both a reactivation and a sweeping process of change, especially since some of them were also showing signs of a renewed openness to foreign direct investment (FDI) or were making attractive offers for the privatization of Government-run public utilities.

As a consequence of all this, by the early 1990s the net outflow of financial resources from the region seen in 1982-1990 had reversed its direction (see table I.8). The countries of the region were regaining access to an abundant supply of private external financing from a variety of sources, although it is true that lenders showed a greater preference for short-term activity than in other developing regions.<sup>8</sup>

8 Between 1990 and 1994, portfolio investment in developing countries as a whole amounted to 41% of their inflows of external resources, as compared to 37% in foreign direct investment (FDI); in Latin America and the Caribbean, however, portfolio investment totalled 66% and FDI came to just 30%. In contrast, in Asia a marked preference for long-term lending was evident (45% in FDI), since only 24% of these resource flows corresponded to portfolio investment (IMF, 1995).

Foreign direct investment and portfolio investment mounted in response to stock and bond offerings made either through direct channels or via ADRs and GDRs, whereas official finance and private debt declined (see table I.9). Net capital flows climbed to 5% of GDP in 1992-1994, thus breaking the previous record high of 4.5% set in 1977-1981. Although resource inflows were concentrated in Mexico, Argentina, Brazil, Chile and Peru, incoming capital flows amounted to over 5% of GDP in 11 of the region's countries (see table I.10).

Thus, although between 1982 and 1990 the Latin American and Caribbean countries found themselves generating a net outflow of financial resources totalling US\$ 218 billion, between 1991 and 1994 they were the recipients of US\$ 207 in net capital inflows that yielded a net inbound transfer of US\$ 79 billion. The case of Mexico was particularly striking, since it went from a net capital outflow of US\$ 9 billion during the first period to a net inflow of US\$ 90 billion in the second.

Between 1992 and 1994, as external constraints eased, the countries of the region began to receive a heavy net inflow of resources which allowed them to cover their growing trade and current-account deficits. Indeed, in 1992 the region's trade deficit reappeared, imports grew twice as fast as exports, and the deficit on current account swelled to over 5% of GDP in nine countries (Bolivia, Costa Rica, Guatemala, Haiti, Honduras, Mexico, Nicaragua, Paraguay and Peru), although in most cases the income they registered on their capital accounts more than outweighed that shortfall (see tables I.10 and I.11).

These large net capital inflows had the effect of driving up expenditure and the deficit on current account to levels that were simply incompatible with macro-economic stability, thereby casting some doubt upon the sustainability of the existing level of external savings. In a

number of countries, these heavy capital inflows had undesired effects on the exchange rate and the money supply, heightened the economy's vulnerability to sudden changes in the external environment, had a negative impact on the tradables sector and diverted income to the consumption of imported goods, to the detriment of domestic saving. The efforts made to neutralize the effect that this absorption of foreign exchange had on monetary variables entailed the maintenance of high interest rates and thus discouraged capital-deepening investments while opening the door to arbitrage activity, all of which limited the manoeuvring room available to monetary policy-makers (see table I.12).

This relatively abundant supply of foreign exchange has triggered a widespread appreciation of the countries' currencies.<sup>9</sup> In a number of cases, the rate of revaluation has outdistanced any reasonable growth rate for net productivity in relation to the countries' main trading partners. This not only erodes the competitive position of exporters and producers of import substitutes, but also hinders any changes in the region's production structures that might stimulate the economy's output of tradables.

Interest payments have become a particularly important variable for Honduras and Nicaragua, since they have been in excess of 6% of GDP in recent years. In Central America as a whole, the current-account deficit has been on the rise, widening from around 8% of GDP in the 1980s to an average of 12.3% in 1992-1994. Since this gap has generally been covered with fairly volatile funds, it is urgent that the countries of this subregion take steps to increase both their exports and their domestic saving rates as well as paving the way for the entry of more stable types of external resources.

<sup>9</sup> Between 1990 and 1994, the currencies of Argentina, Colombia, Ecuador and Uruguay exhibited real revaluations of over 5% per year. Meanwhile, in the space of a single year (1994), Brazil's currency appreciated 21%.

Table I.9  
COMPOSITION OF NET CAPITAL INFLOWS IN LATIN AMERICA AND THE CARIBBEAN<sup>a</sup>  
(Percentages)

	1987	1988	1989	1990	1991	1992	1993
A. Foreign direct investment	25.4	30.1	65.4	16.3	22.6	18.8	15.1
B. Portfolio investment (1+2+3)	7.1	10.8	18.7	40.4	49.7	60.9	75.2
1. Bonds <sup>b</sup>	6.8	10.1	14.2	38.1	35.0	47.0	51.0
a) Short term	15.6	15.4	16.7	37.3	27.8	40.6	31.8
b) Long term	-8.8	-5.3	-2.5	0.8	7.2	6.4	19.2
2. Stock	0.3	0.7	3.4	2.2	11.4	11.3	22.9
3. Commercial paper and certificates of deposit	...	...	1.0	0.0	3.4	2.7	1.3
C. Official financing (1+2+3)	23.7	25.1	44.0	20.5	11.5	2.2	4.2
1. Grants and donations <sup>c</sup>	9.3	8.7	18.7	4.9	8.0	3.8	2.6
2. Loans	17.8	19.7	27.2	13.2	5.4	0.6	2.4
a) Multilateral	11.9	10.4	19.2	8.6	2.9	1.3	2.1
b) Bilateral	5.9	9.3	8.1	4.6	2.5	-0.8	0.3
3. IMF	-3.4	-3.3	-2.0	2.4	-1.8	-2.2	-0.8
D. Private debt (1+2)	43.7	34.0	-28.1	22.7	16.2	18.1	5.5
1. Bank credit <sup>b</sup>	36.6	30.6	-28.9	23.1	19.3	21.1	7.3
a) Long term <sup>b</sup>	19.5	15.4	-49.6	4.6	3.4	6.2	-2.2
b) Short term	17.1	15.2	20.7	18.5	15.9	14.9	9.5
2. Other credit	7.1	3.5	0.8	-0.4	-3.1	-3.0	-1.8
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

Source: ECLAC, on the basis of figures from official sources, the World Bank and International Monetary Fund (IMF).

<sup>a</sup> Inflows of short- and long-term public and private capital, less amortization payments.

<sup>b</sup> Guaranteed and unguaranteed.

<sup>c</sup> Does not include technical cooperation.

Table I.10  
LATIN AMERICA AND THE CARIBBEAN (6 COUNTRIES): NET CAPITAL INFLOWS<sup>a</sup>  
(Annual averages)

	Total net inflow (in billions of dollars)				Percentage of GDP <sup>b</sup>			
	1977- 1981	1983- 1990	1990- 1991	1992- 1994 <sup>c</sup>	1977- 1981	1983- 1990	1990- 1991	1992- 1994 <sup>c</sup>
Latin America and the Caribbean	29.4	9.6	27.8	60.7	4.5	1.3	2.6	5.0
Argentina	1.9	1.4	1.1	10.6	2.0	2.1	0.6	5.1
Brazil	9.3	2.4	3.3	8.9	4.1	0.8	0.8	2.0
Chile	2.6	1.5	2.3	3.6	12.7	7.0	7.3	9.1
Colombia	1.0	0.8	-0.2	1.7	3.4	2.3	0.1	2.9
Mexico	8.2	0.8	16.3	25.8	5.1	0.2	6.3	8.7
Peru	0.8	1.1	2.2	3.7	4.5	4.4	5.8	8.1

Source: 1977-1991: ECLAC, *Latin America and the Caribbean: Policies to Improve Linkages with the Global Economy* (LC/G.1800/Rev.1-P), Santiago, Chile, 1995, chapter IX. United Nations publication, Sales No. E.95.II.G.6; 1992-1994: ECLAC, on the basis of official figures.

<sup>a</sup> Includes long- and short-term capital, unrequited official transfer payments, and errors and omissions.

<sup>b</sup> In view of this percentage's sensitivity to the exchange rate used to convert GDP data expressed in the local currency to figures in United States dollars, for the period 1990-1994 an average of two estimates of this aggregate was employed; one of these estimates is based on a nominal exchange rate that maintains the 1990 parity between the local currency and the United States dollar while the other is based on nominal rates for each year.

<sup>c</sup> The figures given for Mexico generally reflect the trend observed up to October 1994.

Table I.11  
**LATIN AMERICA AND THE CARIBBEAN: BALANCES ON THE TRADE,  
 CURRENT AND CAPITAL ACCOUNTS**  
*(Percentages of GDP)*

	1983-1989			1990-1991			1992-1994		
	Trade	Current	Capital	Trade	Current	Capital	Trade	Current	Capital
<b>Latin America and the Caribbean</b>	<b>3.2</b>	<b>-1.1</b>	<b>1.1</b>	<b>1.4</b>	<b>-1.1</b>	<b>2.6</b>	<b>-1.4</b>	<b>-3.2</b>	<b>4.1</b>
Argentina	3.2	-2.2	1.7	3.5	1.2	0.6	-2.0	-3.2	4.3
Bolivia	-2.2	-12.2	12.4	-2.6	-6.5	6.9	-7.0	-10.0	11.6
Brazil	3.5	-0.4	0.7	1.8	-0.6	0.8	1.8	0.3	1.9
Chile	3.6	-5.6	6.1	4.0	-1.7	7.4	0.4	-3.5	8.3
Colombia	0.6	-2.2	2.3	5.4	3.4	-0.6	-1.3	-2.2	2.9
Costa Rica	-1.5	-8.3	10.2	-3.3	-6.3	7.6	-4.8	-6.5	6.1
Ecuador	4.9	-5.0	5.1	6.5	-4.7	7.3	3.4	-3.8	5.9
El Salvador	-6.6	-5.5	6.3	-11.1	-6.4	7.2	-13.7	-4.1	5.6
Guatemala	-3.0	-4.3	4.6	-3.3	-2.4	5.4	-8.2	-6.14	6.5
Haiti	-16.6	-13.9	14.0	-12.8	-10.1	10.3	-10.1	-6.8	4.7
Honduras	-3.5	-8.5	8.6	-3.7	-10.5	12.0	-5.1	-11.2	10.6
Mexico	4.5	0.3	-0.3	-2.2	-4.5	6.4	-5.1	-7.4	6.4
Nicaragua	-22.5	-33.7	34.9	-24.6	-42.9	44.4	-27.2	-51.5	51.3
Panama	6.9	4.5	-4.9	4.4	-3.4	8.1	0.6	-2.4	3.8
Paraguay	-5.7	-6.8	5.7	-6.2	-5.3	9.8	-10.9	-10.0	10.3
Peru	0.4	-3.2	3.3	-0.9	-3.7	5.2	-3.1	-5.3	8.4
Dominican Republic	-4.9	-5.2	5.2	-2.8	-1.6	3.7	-4.4	-3.4	2.3
Uruguay	4.1	-0.8	1.6	4.0	0.9	0.8	-1.0	-2.3	3.1
Venezuela	5.3	1.4	-3.0	12.0	10.1	-4.9	2.2	-1.0	0.0

Source: ECLAC, on the basis of official figures.

Table I.12  
**LATIN AMERICA AND THE CARIBBEAN (14 COUNTRIES): INTEREST RATES ON DEPOSITS  
 (DOLLAR EQUIVALENTS) IN NATIONAL CAPITAL MARKETS<sup>a</sup>**

	1990	1991	1992	1993	1994	1995	
						I	II
Argentina	138.0	-8.8	13.1	10.1	8.2	14.4	16.4
Bolivia	8.4	12.2	12.4	12.1	12.1	13.1	15.4
Brazil	6.4	30.2	40.8	27.0	54.6	30.7	45.9
Chile	24.0	10.2	16.5	5.9	22.2	3.1	64.8
Colombia	4.0	9.8	-1.4	14.8	26.0	6.0	33.5
Costa Rica	-0.4	-2.8	15.1	6.4	7.9	3.8	4.9
Ecuador	0.2	-1.9	4.1	17.6	11.6	27.0	16.3
El Salvador	-11.4	15.5	-0.8	22.4	12.5	13.2	13.7
Guatemala	-1.7	22.7	6.2	1.9	12.8	3.1	...
Honduras	-50.1	8.6	4.9	-9.6	-12.8	25.2	3.0
Mexico	17.2	12.2	14.0	15.9	-8.5	-83.9	99.2
Peru	-33.8	83.0	12.7	8.8	24.1	-9.2	17.7
Uruguay	0.4	10.9	9.1	10.3	9.0	9.2	12.5
Venezuela	15.3	12.6	9.1	29.6	9.4	23.7	24.3

Source: ECLAC, on the basis of figures from official sources and the International Monetary Fund (IMF).

<sup>a</sup> Averages of quarterly figures.

In Mexico, the rising level of external liabilities, a hefty deficit on current account and the country's dependence on short-term capital flows to balance its macroeconomic accounts generated a financial environment in which economic agents were highly sensitive to the climate of heightened political uncertainty existing in 1994. This situation was exacerbated by the implementation of an expansionary monetary policy at a time when the country was losing international reserves and the public sector's accounts were slightly out of balance. All these factors played a part in setting off the crisis that erupted in December 1994.

In Argentina, the resumption of the flow of external resources into the region gave the economy a strong boost; the implementation of a swiftly-paced trade liberalization programme prior to the introduction of the Government's convertibility plan, which was highly successful in terms of a reduction in inflation, also contributed to the economy's buoyancy. With domestic inflation rates above international levels, the nominal stability of the exchange rate translated into an appreciation of the local currency and made a high level of external saving necessary. However, as a consequence of the Mexican crisis, in 1995 the supply of external credit plummeted, setting off a recession and sharply raising unemployment levels.

#### D. FISCAL TRENDS

The critical state of public finances in the vast majority of the Latin American and Caribbean countries was one of the central aspects of the economic upheavals seen in the region during the 1980s (ECLAC, 1992b). In the present decade—at least up to 1994—the situation has been just the opposite, since almost all the economies have enjoyed a relative degree of stability thanks to the major advances made since 1991; this progress has been made possible, in particular, by the fiscal

adjustment efforts launched in previous years, the widespread implementation of budgetary controls and the resumption of external financing.

##### 1. The fiscal crisis of the 1980s

One of the main manifestations of the fiscal crisis of the 1980s was the difficulty which the public sector had in obtaining financing due to the size of its deficits, which were further increased by recessions and the debt burden, and to the drastic cutbacks made in external financing. This situation led to the use of various combinations of inflationary forms of financing, the suspension of debt servicing and the implementation of fiscal adjustment programmes throughout the decade.

To a great extent, the fiscal crisis was a function of the specific conditions existing in each country, but all the countries did have a number of elements in common, including large fiscal deficits, constraints affecting tax policy, lags in public rates and charges, insufficient financing for State enterprises, the assumption by the State of new types of duties, a reversal in the direction of net transfers of external resources, difficulties in financing the fiscal deficit and a serious deterioration in government operations.

The Governments' financial difficulties, which stemmed both from the unstable nature of their revenues and from the rigidity of their patterns of expenditure, had been building for a long time, but during the 1970s these problems had been masked by the plentiful supply of external resources, which allowed the countries to put off making very necessary fiscal adjustments. In the 1980s, on the other hand, the Latin American economies were confronted with a more complex set of circumstances than before, including, among other factors, the fragility and openness of their financial systems and the vulnerability of their exchange policies.

After the onset of the external debt crisis, the ensuing recession only

exacerbated the existing fiscal emergency, since it depressed tax revenues and considerably enlarged the public-sector deficit. The uncertainty prevailing in many countries and the capital flight that was taking place boosted informal economic activity, which further eroded the tax base.

Soon after the crisis had broken out, tax revenues weakened due to the recession, and the authorities therefore had to adopt fiscal measures to offset that decrease. Moreover, in most cases public utility rates lagged behind inflation, thereby adding to State enterprises' financial difficulties. Trends in the public sector's level of current income varied so greatly –although sharp declines were seen in almost all cases– that by the end of the decade public-sector income levels were lower, in real terms, than they had been at the start of this period in some countries but were substantially higher in others. The main causes of this steep downturn in some of the countries' income levels were the recession, a decline in export prices and surging inflation. The far-reaching crisis of the early 1980s cut into the fiscal revenues of the countries of the region as a whole, and it was therefore not until 1985 that they were able to surpass their 1980 income levels in real terms; towards the close of that decade, however, public-sector income began to strengthen once again, and this helped the region's Governments to carry out fiscal adjustments which had appeared to have little chance of success until that time (see table I.13).

During the 1980s most of the countries' levels of public expenditure plummeted in real terms as a consequence of the adjustment process, despite the increase in their financial burdens. Some countries (Argentina, Bolivia, Ecuador, Peru and Venezuela) made progressive reductions (although not without some ups and downs) in their real levels of public spending during this period, while in others (e.g., Costa Rica, Guatemala, Mexico and Uruguay) income levels regained their initial levels following the

first adjustment process. In Chile, public expenditure rose and fell, but by 1989 it was at virtually the same level as it had been in the early 1970s, whereas Brazil, Colombia and Paraguay had clearly raised their expenditure levels.

The financial burden represented by the public external debt increased at the start of the decade as the real exchange rate and the predominant international interest rate rose; soon thereafter, the cost of the public domestic debt climbed sharply as well due to the exceptionally high level of interest rates. In a situation where the public sector found itself faced with both external and internal financial constraints, the mounting burden of debt service fostered a tendency to reduce primary (current and capital) expenditure more sharply than total expenditure, or to limit its growth more than that of the latter. Under these circumstances, the countries chose to cut spending in areas such as public investment and social expenditure, which had a high cost in social terms (ECLAC, 1994a).

The moratorium on interest payments on the external debt temporarily eased the restraints on primary expenditure, although an actual reduction was seen in very few cases; for the most part, the financial constraints that forced the public sector to resort to a moratorium were so serious that primary expenditure had to be cut as well.

Meanwhile, the reversal of the direction of net resource transfers not only obliged the countries to make drastic adjustments in their external accounts but also, in the great majority of cases, radically altered the financial position of the public sector, which had formerly been the chief recipient of those transfers but which now bore the main responsibility for covering the net payments that had to be made (Altimir and Devlin, 1994). This long period of macroeconomic instability and the magnitude of the adjustment made necessary by external disturbances had far-reaching implications in terms of the public sector's economic and financial behaviour.

Table I.13  
LATIN AMERICA AND THE CARIBBEAN: FISCAL CRISIS AND ADJUSTMENT

Country	First fiscal crisis	Adjustment				Second fiscal crisis	Adjustment				Current status
		Period	T	I	G		Period	T	I	G	
Argentina	1981-1984	1985-1986:	4.6	3.7	0.9	1988-1990	1991-1994:	3.0	4.7	-1.7	Deterioration in 1995
Bolivia	1983-1984	1986-1987:	14.1	15.2	-1.1						Steady
Brazil	1987-1989	1990-1991:	6.4	0.9	5.5	1992	1993-1994:	4.0	1.0	3.0	Deterioration in 1995
Chile	1982-1985	1986-1989:	5.6	-3.1	8.6						Steady
Colombia	1981-1983	1984-1990:	7.4	5.6	1.8						Deterioration in 1995
Costa Rica	1980	1981-1987:	6.1	4.1	2.0	1989-1990	1991-1993:	2.5	1.0	1.5	Deterioration in 1994 and improvement in 1995
Ecuador	1980-1983	1984-1985:	5.4	5.9	-0.5	1986-1987	1989-1994:	9.2	2.0	7.2	Deterioration in 1995
El Salvador	1983-1984	1985-1988:	5.6	-2.1	7.7	1989-1992	1993-1994:	2.8	0.8	2.0	Adjustment continuing
Guatemala	1980-1984	1985-1988:	2.8	2.9	-0.1	1989-1990	1991-1992:	2.3	1.8	0.5	Adjustment continuing
Honduras	1980-1987	1990-1991:	4.0	2.7	1.3	1993-1994					Began new adjustment in 1995
Mexico	1981-1987	1989-1994:	13.5	-0.2	13.7						Deterioration in 1995
Nicaragua	1980-1990	1991-1994:	7.0	5.2	1.8						No change in 1995
Panama	1980-1984	1985-1986:	4.8	1.1	3.7	1987-1989	1990-1994:	6.2	7.5	-1.3	No change in 1995
Peru	1980-1989	1990-1994:	3.9	5.3	-1.4						Deterioration in 1995
Dominican Republic	1980-1983	1984-1986:	2.3	3.2	-0.9	1987-1988	1989-1992:	4.5	0	4.5	Improvement in 1995
Uruguay	1982-1984	1985-1987:	6.8	3.7	3.1	1988-1989	1990-1993:	3.7	3.6	0.1	Deterioration since 1994
Venezuela	1987-1988	1989-1991:	4.9	0.8	4.1	1992-1994					Deterioration continued in 1995

Source: ECLAC, on the basis of official figures.

T: Total magnitude of fiscal adjustment, expressed as a percentage of GDP.

I: Adjustment in current income, expressed as a percentage of GDP.

G: Adjustment in total expenditure (a negative figure denotes an increase), expressed as a percentage of GDP.

## Box 1.2

## "TEMPORARY" AND "PERMANENT" FISCAL ADJUSTMENTS

How can we tell whether a fiscal adjustment is temporary or permanent? In order to distinguish between the two, we first have to determine if, before the adjustment began, economic agents felt that the adjustment measures would later be reversed (whether for technical or political reasons), in which case it would be appropriate to talk about a temporary ("T") adjustment. If, on the other hand, economic agents accept the changes made in the system under the adjustment programme and begin to act in accordance with the new rules, then we may justifiably refer to a permanent ("P") adjustment.

In principle, "T"-type adjustments focus on the achievement of specific short-term goals, usually pursuant to international commitments undertaken by the Government in question. In such cases, economic authorities find it impossible to increase the tax burden in the short run and cover the deficit by cutting public spending (both current and capital expenditure) almost indiscriminately. Adjustments of this sort are ineffective because they involve an actual absorption of resources for the sole purpose of allowing economic policy-makers to "gain time". They might also be regarded as spurious in nature because they are not based on any clear distinction among the various measures used to narrow the current deficit, even while the authorities are fully aware that its reduction may be short-lived.

The best example of the types of measures used in inadequate (temporary) fiscal adjustment programmes are those relating to expenditure. Such measures include the following: i) Wage policies designed to reduce—either drastically or gradually—the real wages of civil servants or of some particular occupational category, such as teachers, medical and para-medical staff, retirees, or law enforcement personnel; ii) The deferral of pay hikes to which the Government has already committed itself in the course of earlier wage negotiations (this may also affect retirees, workers in the education and health sectors, etc.); iii) The suspension of public works and cutbacks in public investment programmes focusing on

the infrastructure needed for given production activities (maintenance and construction of roads, bridges, ports, airports, etc.) or social services (maintenance and construction of schools and hospitals, etc.); and iv) delays in disbursing payments to civil servants, government suppliers or public works contractors.

Although the restoration of the flow of external financing facilitated the consolidation of fiscal adjustment processes in the early 1990s, in some cases the amount of incoming funds exceeded the trend values for such financing and a strong preference for short-term instruments was to be observed, which heightened the country's fiscal vulnerability. In an economy whose growth rate outpaces its potential GDP owing to a massive inflow of short-term external capital, the public sector may be able to maintain its equilibrium or to post a surplus thanks to the tax receipts derived from that growth. Taking a longer-range view, however, if the public sector does not convert those cyclical resources into savings but instead uses them for current expenditures, the least flexible budget items will be thrown out of balance, and the public sector will therefore have to make a costly adjustment in its spending levels once the inflow of resources returns to its trend value.

Permanent or irreversible fiscal adjustments do not suffer from any major inconsistencies in terms of timing as a consequence of technical considerations. Generally speaking, they consist of a combination of spending cuts and increases in revenues based on a medium-term budgetary formula. Furthermore, the rationalization of expenditure is not merely a function of spending cuts, but also involves a redefinition of operations. This type of adjustment also enjoys a greater degree of political backing, either in the form of a mandate given to the authorities by the electorate or through a process of consensus-building among representatives of public opinion. Accordingly, it is less likely that the authorities will be pressured into failing to honour their commitments.

As the adjustment grew more difficult, the task of financing the fiscal deficit also became more complex. These problems were compounded by the fact that the Governments had to assume a large part of the private sector's external debt due to widespread insolvency among private economic agents. This was another of the negative effects of the external debt crisis which was reflected in public-sector accounts. Many countries' central banks had to grant subsidies and reschedule domestic bank debts in order to save the financial system from collapse.

Under these conditions the central banks were the only source of financing for most of the region's Governments, and in order to provide that financing they had to resort to money creation. The adverse effect which this had on the economy's macroeconomic equilibrium was only partially counteracted through the use of monetary instruments and one of its main consequences was a steep increase in domestic prices. Hence, to differing extents, the Governments drew their financing from an "inflation tax", which in some countries was equivalent to over 10% of GDP. This mechanism was an unstable form of financing, however, and was used within the context of an extremely weak fiscal apparatus and serious macroeconomic disequilibria.<sup>10</sup> In contrast, in those economies that had moderate inflation rates, only a limited amount of revenue was obtained via this mechanism, but what income it did provide was predictable and stable and did not significantly alter the country's overall macroeconomic performance.

## 2. The fiscal situation in the 1990s

The sweeping fiscal adjustments which the Latin American countries had to make in order to deal with the crisis in public finances were initiated during the first half

of the 1980s, when the external debt crisis was at its height. These adjustments made it possible to reduce the fiscal deficit by from five to six points of GDP in most of the countries of the region. With few exceptions, they did not produce satisfactory results, however, because external conditions remained adverse.

Therefore, only a few years later the countries had to embark upon another adjustment process, which lasted until the early 1990s. This time their efforts to narrow the external financial gap and to reactivate their economic growth were more successful, and the fiscal deficit was therefore reduced by around three points of GDP. Both of these fiscal adjustments included increases in income as well as spending cuts. Generally speaking, the adjustment programmes typical of the 1980s called for an increase in revenues from all available sources. Particularly notable increases were achieved in the saving rates of State enterprises in Argentina, Colombia, Costa Rica and Chile; in receipts from indirect oil taxes in Ecuador; in social security contributions in Argentina and Uruguay; and in the tax load of local governments in Colombia and Uruguay. The adjustment processes of the 1990s involved fewer countries, were less intensive and placed greater reliance on an increase in tax receipts stemming from the growth of economic activity; this made it possible for the restrictions on expenditure levels—which had already been reduced considerably during the adjustment programmes of the 1980s—to be less stringent.

Fiscal revenues have risen in most of the countries in the region during the 1990s (see table I.13). In 10 countries (Argentina, Chile, Colombia, Dominican Republic, El Salvador, Nicaragua, Panama, Paraguay, Peru and Uruguay), real receipts have exceeded their 1980 level by 25% or more. In particular, Brazil's revenues have rebounded strongly since 1993, following a slump in

<sup>10</sup> The revenues obtained by central banks from such an "inflation tax" have been used to finance the quasi-fiscal deficits which are concealed in those banks' accounts.

1991-1992. In these cases, the increase in fiscal income has been the result both of higher tax receipts and an upturn in revenues from State enterprises; in some instances, the non-recurring income obtained from privatizations has also been a contributing factor.

As a consequence of the adjustment, during the 1980s public expenditure diminished substantially in real terms in most countries in the region, but during the 1990s this trend has begun to reverse direction. In fact, public spending levels reached record highs in nine countries in 1994 (Argentina, Bolivia, Chile, Colombia, Costa Rica, Dominican Republic, Paraguay, Uruguay and Venezuela) and did so in Honduras in 1993. In Brazil, however, total expenditure mounted during the 1980s, peaked in 1987 and has declined steadily ever since, with the exception of 1992. In the majority of the remaining countries, expenditure has also recovered appreciably in recent years, but even so 1994 spending levels were still lower than they were in the early 1980s.

The recommencement of external credit flows, the resumption of growth and the price stability seen in the Latin American economy in 1990-1994 also helped to improve its fiscal performance. The possibility of obtaining voluntary financing in international markets provided broader opportunities for domestic borrowing while at the same time lowering its cost. The appreciation of the countries' currencies, which was also associated with the restoration of capital inflows and a build-up of reserves, meant that interest payments on the external debt placed less of a burden, in real terms, on government budgets. The response of tax receipts to the increase in the pace of economic activity was quite elastic; tax revenues also improved thanks to the decline in domestic interest rates brought about by the reduction in international rates and the discontinuation of the credit rationing which had affected many countries in the region, as well as to a more rapid increase in output. Lower inflation rates also contributed to the increase in real revenues.

All these factors have helped to re-shape the fiscal situation. The effects that the countries' varied and wide-ranging structural reforms have had in various spheres of the public sector have also played a role in this connection. These measures have included the reformulation of some aspects of tax policy, whose emphasis has shifted to excise taxes, the broadening of the tax base and lower tax rates, tariff reductions, and the refinement of legal and administrative aspects of tax auditing procedures. Another important component of these structural reforms has been the sale of State enterprises and an expanded programme for privatizing public utilities. The decentralization process has also been carried forward and civil-service institutions have been downsized. In addition to speeding up the privatization of their social security systems (i.e., medical care and pensions), the countries have adopted policies aimed at upgrading the effectiveness and equity of social spending.

In sum, during the 1980s and 1990s major changes have occurred in the chief components of the Latin American and Caribbean countries' public-sector accounts. Furthermore, although the various countries' performances differed from one another during the most recent stage (1991-1994), a general trend towards a reduction of the fiscal imbalance has been observed (see table I.14).

#### **E. ECONOMIC PERFORMANCE IN TERMS OF EMPLOYMENT AND SOCIAL EQUITY**

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The growth achieved by Latin America and the Caribbean in the post-war period entailed a rapid rate of job creation and sweeping changes in a labour force that was expanding by 2.5% per year. Rapid urbanization reduced the percentage of the working population employed in the farm sector from 55% of the total in 1950 to 32% in 1980. The number of jobs created by the formal urban sector rose at an annual rate of 4%, but this was not fast enough to absorb all the new entrants into

Table I.14  
**LATIN AMERICA AND THE CARIBBEAN: THE PUBLIC-SECTOR  
 BALANCE AT CURRENT PRICES<sup>a</sup>**  
*(Percentages of GDP)*

	Level <sup>b</sup>	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994
Argentina	NNFPS	-5.5 <sup>b</sup>	-9.6	-10.6	-10.5	-8.3	-4.3	-3.3	-5.3	-8.2	-3.7	-3.8	-1.6	-0.1	-0.1	-0.4
	WP													-0.9	-0.3	-0.7
Bolivia	NFPS	-7.8	-7.6	-14.2	-17.9	-26.6	-10.9	-3.1	-7.3	-5.8	-4.8	-3.9	-3.7	-4.8	-5.8	-4.2
Brazil	CPS	-1.6	-3.2	-4.1	-4.1	-3.4	-4.2	-3.6	-5.7	-4.8	-6.9	1.2	-0.2	-2.8	-1.3	1.2
Chile	CG	6.5	2.8	-3.4	-2.6	-2.9	-3.8	-0.8	1.9	1.7	2.8	3.5	2.4	2.8	2.0	2.0
Colombia	NFPS	-2.6	-5.3	-6.0	-7.6	-6.3	-4.0	-0.3	-1.9	-2.2	-1.9	-0.6	0.0	-0.2	0.3	2.6
	CG	-8.1	-3.5	-2.6	-4.3	-3.1	-2.0	-3.4	-2.0	-2.5	-4.1	-4.4	-3.1	-1.9	-1.9	-7.0
Ecuador	NFPS						-1.7	-1.8	0.0	0.1	0.0	-2.5	-0.1	0.7	0.6	-6.9
	NFPS	-7.4	-8.5	-7.2	-5.2	-1.2	0.2	-3.7	-9.6	-5.3	-1.6	0.6	-1.0	-1.7	-0.4	-0.2
El Salvador	CG	-5.3	-6.6	-7.0	-8.8	-5.8	-3.8	-2.8	-3.8	-3.2	-4.9	-3.6	-5.2	-5.2	-3.3	-2.1
Guatemala	CG	-4.7	-7.4	-4.7	-3.3	-3.8	-1.8	-1.9	-2.4	-2.4	-3.8	-2.3	-0.1	-0.5	-1.5	-1.5
Honduras	CG	-8.7	-8.1	-13.0	-10.9	-12.3	-9.8	-8.7	-8.1	-6.9	-7.4	-6.4	-3.3	-4.9	-9.3	-5.2
Mexico	CG	-3.2	-7.0	-12.9	-8.6	-7.7	-8.2	-13.2	-14.3	-9.7	-5.1	-2.8	-3.5	4.8	0.8	-0.4
	WP												-0.2	1.6	0.4	-0.8
Nicaragua	CG	-9.3	-11.7	-13.2	-28.7	-23.6	-22.4	-17.3	-16.6	-26.6	-6.7	-17.1	-7.5	-7.6	-7.3	-9.7
Panama	CG	-9.3	-7.8	-12.9	-5.7	-6.7	-2.1	-1.9	-4.5	5.3	7.0	-0.7	-2.7	-1.4	-0.4	-0.8
Paraguay	CG	0.3	-2.2	-0.1	-2.0	-2.5	-1.2	1.0	-0.2	0.7	1.5	3.0	4.4	-0.1	-0.7	0.8
Peru	CG	-2.4	-4.0	-3.2	-7.5	-4.4	-2.2	-3.7	-5.7	-2.5	-4.2	-2.5	-1.4	-1.4	-1.6	2.1
Dominican Republic	CG	-2.9	-2.3	-3.1	-2.8	-0.9	-1.5	-0.5	-2.2	-1.6	-0.1	0.3	2.8	2.9	-0.4	-1.1
Uruguay	CG	0.0	-1.5	-9.1	-3.9	-5.2	-2.9	-1.2	0.1	-2.0	-3.4	-0.1	0.4	0.3	-1.1	-2.3
	CPS	1.1	-1.8	-11.1	-4.0	-4.5	-2.3	-0.7	-0.9	-4.5	-6.1	-2.5	0.0	0.5	-1.5	-3.0
Venezuela	CG	-0.2	2.8	-1.1	-2.0	2.5	2.3	-0.5	-5.0	-6.2	-1.0	-2.1	2.8	-3.6	-3.4	6.5
	NFPS				-2.4	6.8	3.2	-5.3	-4.4	-8.6	-1.1	0.2	0.2	-5.8	-3.5	-13.8

Source: ECLAC, on the basis of official figures.

<sup>a</sup> A minus sign (-) indicates a deficit. <sup>b</sup> NNFPs: National non-financial sector. NFPS: Non-financial public sector. WP: Refers to the hypothetical situation that would result if income from privatizations were not included in total revenues. CPS: Consolidated public sector. CG = Central government.

the urban workforce, whose rate of under-utilization (unemployment plus employment in informal economic activities) remained at around 30% (Tokman, 1991).

The employment of broad sectors of the urban population in informal activities and the existence of a large, relatively unproductive labour force in small-scale agricultural activities are part of the reason why many Latin American and Caribbean countries have some of the highest indexes of income inequality in the developing world. In urban and rural

areas alike, deeply rooted income inequalities stem from sharp differences in educational levels, the segmentation of labour and credit markets, and striking inequalities in terms of access to land.

Thus, when the long period of inward-looking growth came to an end in 1980, a majority of the Latin American and Caribbean countries' income distribution patterns were more inequitable than they had been in the 1960s or early 1970s.<sup>11</sup>

However, because of the countries' economic growth and the modernization

<sup>11</sup> The only exception was Venezuela between 1970 and 1980; it is possible that Colombia and Mexico should be added to this list, depending on how comparable the relevant data are (Altimir, 1994).

of some segments of the farm sector, absolute poverty –a situation in which around 40% of Latin American and Caribbean households found themselves in 1970– had tended to diminish in the 1970s. This decline was quite widespread in rural areas, but this was not the case in urban areas due to differences between these two types of zones' growth and job-creation rates and to unequal patterns of income distribution (Altimir, 1994).

### **1. Distributional costs of the crisis and adjustment process**

The crisis and adjustment processes of the 1980s shattered the fragile balance in employment which the region had struck during its preceding growth phase. Real wages shrank, open unemployment climbed, and the percentage of jobs located in segments having lower average productivity levels increased. Overall, the portion of the region's urban labour force that was employed in sectors which typically underutilized their workers' capabilities expanded at an average rate of 5% per year. In contrast, employment in formal activities grew by half that amount, and most of that increase was accounted for by small firms and, to some extent, public-sector enterprises (see figure I.2).

As a result of this trend in the region's labour markets –whose effects were, in some cases, compounded by rising inflation and an increase in the capital gains made possible by financial speculation or swiftly-paced deregulation programmes– the region's income concentration became even more pronounced during the crisis and the adjustment processes of the 1980s. In almost all the countries of the region, a large-scale redistribution of income occurred during that decade, and by its end those countries' inequality indexes were therefore higher than they had been before the crisis. Only Colombia and Uruguay arrived at the end of the decade with a level of income inequality

that was about the same or less than it had been at the start of the 1980s.

As noted above, the degree of inequality lessened during the subsequent recovery from the external adjustment in just two countries –Colombia and Uruguay– while in the rest it remained the same or became even worse.

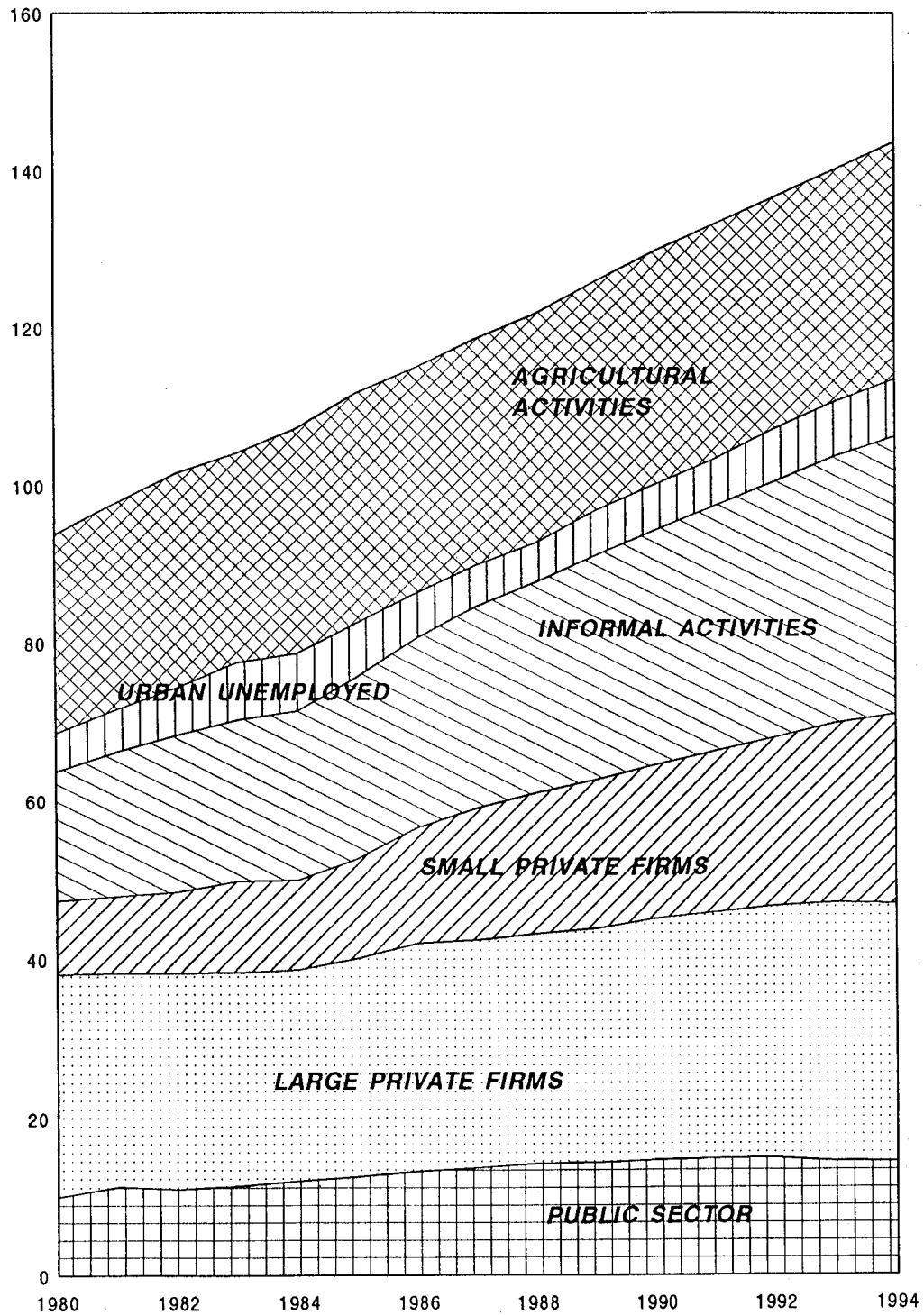
Some countries lapsed into another recession after they had recovered from the external adjustment due to persistent domestic imbalances and the failure of their attempts to stabilize their economies, and these countries witnessed a further deterioration in their distributional patterns. In some countries, such as Argentina, which later on managed to bring their spiraling inflation under control and therefore experienced an upturn in economic activity, a limited improvement was seen in income distribution (see table I.15).

The growing inequality and declining per capita incomes seen in the first half of the 1980s drove up the level of urban poverty; only a few countries were later able to turn this situation around by dint of their subsequent stabilization efforts and economic reactivation. In 1990, 39% of the region's households were below the poverty line, versus 35% in 1980. The increase in poverty was much sharper in urban areas, where the number of such households swelled from 25% to 34% during that period (ECLAC, 1995f).

### **2. Job creation and social equity in the region's new phase of growth**

In countries that were able to rectify their main imbalances, the economic recovery was initially based on a fuller utilization of installed capacity without necessarily entailing any major changes in the mix of production factors being used. Therefore, GDP growth was to a large extent expressed in an increased demand for manpower; as a result, unemployment levels descended and the relative

Figure I.2  
**LATIN AMERICA AND THE CARIBBEAN: UTILIZATION OF THE LABOUR FORCE**  
*(Millions of persons)*



Source: ECLAC, on the basis of figures from the Regional Employment Programme for Latin America and the Caribbean (PREALC).

Table I.15  
LATIN AMERICA AND THE CARIBBEAN: WELFARE INDICATORS  
FOR THE 1980s AND EARLY 1990s

Country	Year	Real per capita income (indexes)	Poverty (% households)		Concentration of income in urban areas (Gini) <sup>a</sup>	Utilization of labour force <sup>b</sup> (indexes)	Real wages (indexes)	Per capita social expenditure (indexes)
			National	Urban				
<b>I. Countries with per capita incomes above pre-crisis levels</b>								
<b>Colombia</b>								
1980		100	39	36	0.518	100	100	100
1986		105	38	36	0.455	92	120	109
1990		112	...	35	0.450	99	118	117
1992		113	...	38	0.454	96	116	128
1994		121	...	...	...	94	122	...
<b>Costa Rica</b>								
1981		100	22	16	0.328	100	100	100
1990		103	24	22	0.345	103	98	112
1992		110	25	25	0.362	106	97	96 <sup>c</sup>
1994		116	...	...	...	97	112	...
<b>Chile</b>								
1981		100	...	...	...	100	100	100
1987		90	39	38	0.485	100	87	85
1990		103	33	33	0.471	108	96	82
1992		111	28	28	0.474	110	106	97
1994		118	24	24	0.479	106	114	...
<b>Uruguay</b>								
1981		100	11	9	0.379	...	100	100
1990		90	...	12	0.353	...	85	101
1992		101	...	8	0.301	...	91	118 <sup>c</sup>
1994		108	...	...	...	...	96	...
<b>II. Countries with per capita incomes below pre-crisis levels</b>								
<b>Argentina</b>								
1980		100	9	5 <sup>d</sup>	0.365 <sup>d</sup>	100	100	100
1990		72	...	16 <sup>d</sup>	0.423 <sup>d</sup>	88	77	75
1992		85	...	10 <sup>d</sup>	0.408 <sup>d</sup>	85	79	89
1994		95	...	...	...	72	78	...
<b>Brazil</b>								
1979		100	39	30	0.493	100	100	100 <sup>e</sup>
1990		98	43	39	0.535	94	116	125
1994		100	...	...	...	85	108	...
<b>Mexico</b>								
1981		100	...	...	...	100	100	100
1984		88	34	28	0.321	96	72	66
1989		83	39	34	0.424	86	73	59
1992		88	36	30	0.414	86	86	74 <sup>c</sup>
1994		88	...	...	...	82	97	...
<b>Panama</b>								
1979		100	36	31	0.399	...	100	...
1989		93	38	34	0.460	...	114	...
1991		85	36	34	0.448	...	111	...
1994		90	...	...	...	...	112	...
<b>Peru</b>								
1979		100	46	35	...	...	100	100 <sup>e</sup>
1990		72	...	...	...	...	44	40
1994		81	...	...	...	...	56	...
<b>Venezuela</b>								
1981		100	22	18	0.306	100	100	100
1990		75	34	33	0.378	93	48	65
1992		76	33	32	0.380	94	47	...
1994		70	...	...	...	85	36	...

Source: ECLAC, on the basis of official figures.

<sup>a</sup> Calculated on the basis of the distribution of per capita income among households, by deciles. <sup>b</sup> Percentage of the non-agricultural labour force employed in formal activities. <sup>c</sup> 1991. <sup>d</sup> Metropolitan area (Greater Buenos Aires). <sup>e</sup> 1980.

expansion of low-productivity sectors began to subside or came to a halt altogether. At the same time, real wages rebounded thanks to lower inflation and a strong demand for labour.

However, once a fuller utilization of installed capacity had been attained, both the risks involved in structural reforms and the opportunities they offer in terms of the labour market began to become more evident.

The hazards with regard to employment and labour income which are associated with the changes now taking place are essentially as follows:

- The possibility that trade liberalization, the downsizing of the State apparatus and other such measures may lead to a serious loss of jobs in activities which may cease to be viable unless support is provided for their restructuring;

- The possibility that increases in the international competitiveness of rapidly expanding activities may be based on the use of techniques that are not labour intensive, which would limit direct job creation;

- The possibility that, in addition to the foregoing, most new jobs may be in low-productivity activities, and that large sectors of the labour force would therefore remain on the sidelines of the modernization process;

- The possibility that the demand for persons possessing certain skills (or for more highly qualified persons even at the same skill or educational level) may outstrip the supply, which would open up wide wage gaps between strata or even within individual strata that might persist over long periods of time;

- The possibility that a correlation between productivity and wages may be lacking in the most dynamic branches of activity due to technological and socio-political factors, which would give rise to an asymmetrical distribution of income.

In all these cases, a tendency may arise towards polarization and the marginalization of certain groups, which

would then be reflected in a deterioration of those groups' positions within the labour market. Some of these hazards are inherent in the initial stage of processes of change, when certain activities may cease to be viable before new segments have been formed that will make up for the consequent loss of jobs and income. Accordingly, many authors have acknowledged the fact that the labour market is bound to undergo a crisis during transitions of this type (García, 1993; World Bank, 1995).

On the other side of the coin, a changeover from one development style to another opens up opportunities for the creation of productive jobs and higher wage levels as a consequence of the growth that goes along with international competitiveness. There is a direct correlation between the expansion of internationally competitive sectors and direct job creation, and the closer such a sector's links to other activities in the production system are, the more jobs it will create via indirect means throughout the entire system. What is more, business enterprises in internationally competitive sectors are constantly obliged to make changes in their structures and production systems, and this calls for an ever greater incorporation of technology and skilled manpower. If the demand for these factors continues to climb on a sustained basis, then the supply of skilled workers will also increase, and in the long run it will therefore become possible to narrow the wage gap and boost average wage levels in real terms. Increasing productivity is another way of raising wages in a competitive environment.

Not all the countries in the region have taken equal advantage of these opportunities. Even in countries that have achieved a high rate of export-based growth, job creation has not been concentrated in export sectors—even though enclaves have developed within those sectors (e.g., maquila industries and some agricultural activities) that have created a large

number of jobs— but instead in the production of non-tradable goods and services (Pollack, 1993).

The risk factors mentioned earlier have thus far been the most significant ones for the region. In the early 1990s, the link between growth and job creation was weak. Only in a few countries did higher growth rates lead to decreases in unemployment levels; in others, open unemployment actually rose. Furthermore, most newly created jobs continue to be in low-productivity, low-paying sectors, while the share of jobs provided by formal activities (large private firms and public-sector enterprises) has diminished (ILO, 1994 and 1995) (see figure I.2).

The differing extents to which these risk factors have influenced the various countries' labour markets and the potential for changes in their production patterns, as well as the stage that this process has reached, have given rise to a series of dissimilarities. In 1994, the situation was better than it had been in the 1980s in terms of both urban unemployment and real wages in a few countries (Chile, Colombia). In others (Brazil, Costa Rica, Mexico), unemployment was down while real wages in formal economic activities had regained their former levels (see table I.16). Bolivia was the only country that experienced a decline in urban unemployment in combination with a drop in wages. Then there were a number of countries (Argentina, Ecuador, Nicaragua, Peru and Venezuela) in which higher unemployment was coupled with lower real wages (with wage levels similar to those of 1980 in the best of cases), while only Panama had both higher wage levels in the modern sector and higher unemployment.

Just as the situation in the labour market involves more than simply employment and wage levels in the formal sector, the underutilization of the labour force does not begin and end with open unemployment. The varied forms taken on by underemployment in the

informal sector are a reflection of the precarious nature of the employment structure, which became even more unstable in the 1980s and has not improved since. During the period under consideration here, there was a proportionate increase in occupations associated with lower average levels of productivity, together with a comparative decline in the incomes of own-account workers, especially those working in non-professional and non-technical capacities (ECLAC, 1995f).

Although the educational level of members of the labour force continued to climb, weak demand for skilled workers during the 1980s caused their wages to drop in relation to those of less skilled personnel. This trend appears to have reversed itself in the 1990s, at least in some countries and in the case of university-trained professionals.

In many instances, demand has slackened for certain types of skills possessed by workers who were previously employed in activities whose importance has been waning, while at the same time demand has strengthened for specialists in disciplines that are needed in expanding sectors. The combination of these two trends has altered the activity-based wage structure to an as yet undetermined degree.

These changes, all of which affect income distribution, are a reflection of numerous factors: abrupt changes in the external economy, the macroeconomic adjustment, unsuccessful adjustment efforts and mounting inflation, structural reforms and the micro-economic restructuring processes currently under way. This makes it difficult to determine exactly how much each of these factors has influenced income distribution and employment. What we can do, however, is to analyse the situations that have taken shape after these economies have completed their recovery, once they are operating at something near full capacity within a new macroeconomic and regulatory framework on the basis of a newly emerging development style.

Table I.16  
**LATIN AMERICA AND THE CARIBBEAN: COMPARISON OF REAL AVERAGE WAGES AND  
 OPEN URBAN UNEMPLOYMENT 1980-1994**

Real average wages (modern urban sector)	Level of open urban unemployment	
	Worse	Better
Better	Panama <sup>a</sup>	Chile Colombia
Same	Guatemala Paraguay Uruguay	Brazil Costa Rica Mexico
Worse	Argentina Ecuador <sup>b</sup> Nicaragua Peru Venezuela <sup>b</sup>	Bolivia

Source: ECLAC, on the basis of official reports from the countries.

<sup>a</sup> Wages levels for 1980 and 1993 were used for this comparison.

<sup>b</sup> Due to the unavailability of data on real average wages, the minimum wages for the relevant years were used for this comparison.

Colombia and Uruguay are the only countries which have ended up with less inequality than before the crisis. Chile, which is quite far along in the process of changing its production patterns and has embarked upon a sustained growth path, emerged from the crisis with a level of inequality that was much the same or higher than before,<sup>12</sup> and this level has declined by no more than a limited extent during the latest growth phase. Meanwhile, Costa Rica has witnessed a gradual deterioration in its distributional equity (see table I.15). Nevertheless, these countries (with the exception of Uruguay) are utilizing a similar or higher percentage of their urban labour force and have attained equal or higher real wage levels.

As of 1992, after having completed their adjustment processes, bringing

inflation under control and implementing reforms, Argentina and Mexico exhibited a higher degree of income inequality than before the crisis. In both cases the underutilization of the labour force had escalated as well, while real wages had lost ground.

In the early 1990s, trends in the incidence of poverty were quite mixed in the countries of the region. Whereas the percentage of households below the poverty line rose in almost all the countries during the 1980s, during the initial years of this decade some nations managed to alleviate this problem. Many economies have not grown rapidly enough to reduce poverty to any significant degree, however, although in the early 1990s some countries (including Argentina, Bolivia, Chile, Mexico and Uruguay) registered a considerable decrease in this indicator

<sup>12</sup> According to data compiled for an employment and income survey conducted by the University of Chile, the concentration of household income in Greater Santiago increased slightly (by 2%) between 1978 and 1987. However, the results of an income and expenditure survey carried out by Chile's National Institute of Statistics (INE) indicate that the concentration of expenditure rose by 9% between 1978 and 1988. This last figure is considered to be quite high (Altimir, 1996).

(ECLAC, 1994d and 1995f). Nevertheless, only Chile and Uruguay have managed to drive poverty below its pre-crisis levels; this achievement may be attributed to economic growth in the first case and to an improvement in income distribution in the second (see figure I.3).

In summary, except in a few isolated cases, the growth phase that began in the 1990s has not brought any significant progress in terms of job creation or greater social equity. Furthermore, the after-effects of the crisis have simply added to the pre-existing backlog of social needs. The economic reactivation seen in recent years has only partially counteracted these effects, and sustained economic growth has not, in and of itself, helped to improve the region's regressive distribution of income; on the contrary, a number of adverse trends are to be observed in this respect. In some instances these trends may well be temporary in nature, but in others they could become characteristic traits of the new development style, and in such cases appropriate policy measures may be needed to prevent this from happening.

## F. THE EXPERIENCE GAINED

### 1. The characteristics and sequencing of the financial liberalization process

There were both external and internal reasons why the 1994 Mexican crisis did not have a domino effect. Some of the external factors were the buoyancy of the world economy and international trade (in contrast to the situation in 1982); moreover, the terms of trade were favourable for exporters of raw materials, interest rates were low and the dollar was weakening. Internal factors included the phase of intense activity which a number of the economies in the region (Brazil, Colombia, Chile, El Salvador and Peru) were experiencing and the dynamism of intraregional trade flows, as well as the headway made in implementing

economic reforms, lowering inflation and reducing fiscal imbalances.

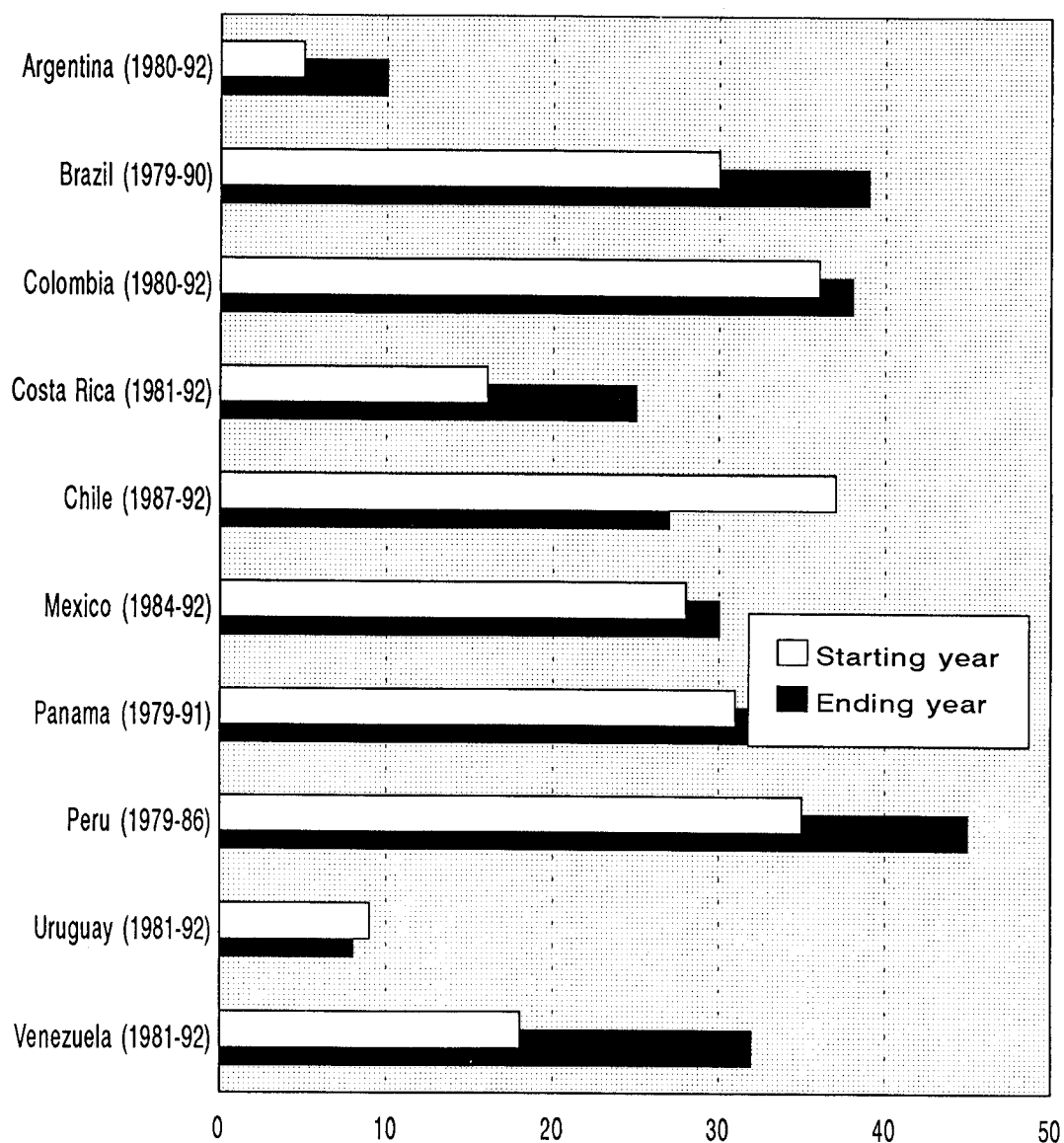
Despite the impact of the Mexican crisis, the region's overall macroeconomic situation is more stable, and its economies are regaining some measure of their growth capacity as well as witnessing an increase in their saving and investment rates and an expansion and diversification of exports. The fact that real exchange rates are lower than they were in the mid-1980s does, however, create greater demands in terms of saving and productivity.

The deficit on current account has proven to be an important indicator of how sustainable an open economy's macroeconomic equilibrium may be. It is not regarded as being a cause for concern if it is moderate in size (1%-2% of GDP) and/or sustainable (i.e., if it is financed primarily with long-term capital inflows). Nor is it serious if it does not take the place of national saving but instead supplements it and is primarily channeled into an increase in investment rather than in consumption, and when it is wisely invested in tradables that boost the country's credit standing.

This set of factors is conducive to saving because it helps ensure that external and internal saving will complement one another. In the absence of suitable policies, external saving will tend to dampen national saving, especially if sharp increases in this variable cause it to move too far away from its trend value.

As practical experience has demonstrated, measures designed to stabilize the inflow of external capital can prevent it from contributing to the distortion of key prices in the economy, such as exchange and interest rates. A number of Governments have intervened in the exchange market in an attempt to stop this from happening; in such cases they have not confined themselves to the purchase of foreign exchange but have also sterilized the monetary effect of those purchases by issuing domestic debt paper. Chile and Colombia have also encouraged inflows of long-term resources while at the same time attempting to limit the entry of

Figure I.3  
**LATIN AMERICA AND THE CARIBBEAN (10 COUNTRIES): URBAN POVERTY**  
*(Percentage of households living in poverty)*



**Source:** ECLAC, *Social panorama of Latin America, Edition 1995* (LC/G.1886-P), Santiago, Chile, 1995. United Nations publication, Sales No. E.95.II.G.17.

short-term funds through the use of specific disincentives. In 1995, Brazil and Peru also began to move towards the implementation of policies having a similar thrust, although on a less intensive scale. These policies are not without their costs,<sup>13</sup> but they have proved to be effective during transitions to greater financial integration.

In the most noteworthy cases in which countries –both in the region and elsewhere– have had to handle heavy inflows of external financing, they have addressed the problem with integrated economic policy packages designed to achieve greater fiscal austerity and boost domestic saving; the policy measures included in such packages have included sterilization operations, the phasing out of capital controls and of limitations on the outflow of resources, a moderate appreciation of the local currency and deterrents to excessive inflows of short-term capital (ECLAC, 1995b).

Meanwhile, in the region, the events of recent years have shown that a combination of little or no exchange-rate uncertainty,<sup>14</sup> intervention in the market aimed at sterilizing incoming funds –which holds back the convergence of interest rates– and the liberalization of capital inflows will foster an influx of short-term capital and heighten its destabilizing effects (IMF, 1995).

The pace at which a country opens up its capital account should be geared to the

economy's absorption capacity and its ability to achieve an effective allocation of external resources so that it can reinforce its macroeconomic stability and avoid fluctuations in the real exchange rate. In such a situation a real devaluation is called for in order to ensure that the liberalization of the trade account will yield satisfactory results and that the cost of making the transition from one production and occupational structure to another will not be too high.<sup>15</sup> Since financial markets adapt more swiftly than product markets do, a premature liberalization of the capital account may trigger a steep appreciation of the currency and thus send out contradictory signals regarding a country's trade and financial liberalization process.

Since restructuring the production system takes quite some time to accomplish, experience has also demonstrated the importance of avoiding excessive appreciations during the transition period. Depending upon each country's characteristics, the authorities may choose to impose systematic controls on financial flows, take steps to block destabilizing movements and ease the restrictions placed on the capital account once the new production structure is firmly established.

If the financial liberalization process is too abrupt and sets off a massive influx of capital, then the current-account deficit may grow so large that it severely

13 These include the microeconomic costs arising from the reduced efficiency of financial intermediation and the macroeconomic costs associated with the quasi-fiscal losses which the monetary authority incurs by paying out more in interest on the domestic debt than it accrues on the international reserves built up as a result of such policies. Nor would it be wise to try to neutralize all of the effects that such a step will have on the exchange rate, even if they are thought to be only temporary, since this could stimulate currency arbitrage and limit monetary policy-makers' freedom of action.

14 In April 1994 the Mexican financial authorities encouraged economic agents to exchange government securities denominated in pesos (CETES and others) for *Tesobonos*, whose value was pegged to the exchange rate. In practice, this eliminated exchange-rate uncertainty altogether. Owing to the economic environment's sensitivity to political and economic disturbances, the total value of *Tesobonos* in circulation skyrocketed from less than US\$ 2 billion in April to nearly US\$ 29 billion in December 1994.

15 Between 1987 and 1991, six countries in the region launched trade liberalization programmes or took steps to carry their liberalization process further; these efforts coincided with a sharp appreciation of their currencies. The resulting combination of heavier capital inflows and less expensive imports triggered an inordinate increase in the latter. See ECLAC, 1993c.

jeopardizes the country's macroeconomic equilibrium, as well as being unsustainable over the medium term. Such a state of affairs may be compounded by upward pressure on the price of domestic assets –land, equity and stock– whose “wealth effect” spurs consumption and enlarges the deficit. All these factors will heighten the level of country risk and expectations of a devaluation; under such circumstances, capital flows will tend to reverse their direction, which will either throw the country into a deep recession or make it necessary to undertake traumatic devaluations in order to rectify this external imbalance.

It is therefore generally agreed that the capital account should be opened up rather gradually and only once other liberalization processes, particularly in the area of trade and in the domestic financial market, have been consolidated (Edwards, 1984). The need for such an approach notwithstanding, some attention should also be paid to the specific characteristics of each country. For example, the economic policies of a given country may make it inadvisable to use certain instruments (e.g., capital controls). In other instances, it may be necessary to implement an economic reform package at the same time due to considerations of political economy, as has been the case in Bolivia and Peru. In still others, the existence of a history of hyperinflation may call for the adoption of exchange-rate anchors and systems of free convertibility in order to attract external savings to backstop the country's stabilization and growth, as in Argentina.

Be that as it may, the reasons for sequencing economic reforms in the manner described above remain valid, as do those for maintaining a prudently-sized deficit on current account and a certain level of competitiveness. The most important point is to decide how best to meet the economic policy challenges posed by a new set of conditions which create greater demands in terms of fiscal austerity and productivity growth.

The reversal of the direction of net resource transfers is not the only reason why the current economic situation in Latin America is as it is. The countries' thorough-going economic reforms and the turnaround in their economic policies have also played a role. In fact, the region as a whole actually registered a negative transfer of resources in 1995, but even so the performances of most of its economies (with the exception of Argentina, Mexico and Uruguay) were similar or better than the year before.

## 2. Fiscal management

Two of the region's external adjustment “success stories” –Chile and Colombia– are also noteworthy for having achieved a lasting fiscal equilibrium. These two countries' public-sector accounts were in better shape prior to the crisis than those of the other countries analysed here; throughout their fiscal adjustment processes, they continued to undertake essential public investments, and they now have the highest ratios of tax receipts and current income to GDP (not counting the revenues obtained from privatizations). In short, Chile's and Colombia's fiscal adjustments were based on economic growth and were centered around an effort to reduce expenditure and optimize its efficiency in combination with an increase in tax revenues and current income.

The situation as it now stands in the countries of the region leads to the conclusion that the availability of external financing, the traits of the national capital market in question, fluctuations in the level of domestic economic activity and the severity of inflation are exogenous determinants of the degrees of freedom and effectiveness of a country's fiscal management. For example, a sudden curtailment of the flow of external savings or of its availability at a crucial point in time will determine the nature of a country's adjustment process and will influence both its overall economic activity and the performance of its public sector.

With respect to national capital markets, the events of the 1980s demonstrate that resorting to the use of domestic public-sector credit is extremely costly. In most cases, the public sector's financial needs outstripped the capacity of Latin America's financial systems, and real interest rates therefore skyrocketed. Moreover, given the public sector's shaky financial standing, a large risk premium was added to these real interest rates. This premium was proportionately larger during times of uncertainty as to the level and stability of the real exchange rate. The slump in domestic saving, combined with these high interest rates, discouraged any revival of private investment and thus deepened the recessionary effects of the adjustment. What is more, the higher cost of public borrowing drove up the level of debt in real terms, thereby putting the countries at greater risk of incurring deficits in the future.

In addition, a number of countries in the region have witnessed a slackening of activity and high, persistent rates of inflation. It is now acknowledged that the fiscal deficit's monetary effect is one of the causes of inflation, whose impact is magnified due to the generally low level of monetization. Inflation has, in its turn, adversely affected fiscal accounts by eroding tax receipts in real terms and hindering the implementation of a pricing policy for public utilities as well as the management of the budget. Downswings in the level of economic activity have also hurt tax revenues. In sum, it should come as no surprise that the most successful attempts to bring the fiscal situation under control and to minimize the cost that the rest of the economy must pay for that achievement have taken place in economies marked by higher rates of growth, lower inflation, a gradual correction of key relative prices, lower levels of domestic debt and a more ample supply of external financing.

There is no question about the fact that, in addition to differences in the macroeconomic situation, the way in which fiscal variables have been managed

has varied from one country to the next and that the size of the imbalance existing before the outbreak of the debt crisis has also exerted a strong influence. For example, the fiscal crisis of the early 1980s was less severe in Colombia than in other countries precisely because its pre-crisis level of debt was lower. Second, it is becoming clear that the ability to derive income from the development of State-owned natural resources played an important role in some of the more successful adjustment processes, especially in the case of Chile. A third noteworthy factor is the degree to which the objective of increasing or maintaining the existing tax burden was achieved, inasmuch as a number of countries undertook sweeping tax reforms that helped to consolidate their fiscal adjustments. A fourth consideration is the degree of effectiveness of cost-cutting measures, especially in cases where they enabled the authorities to continue to make certain types of public investments or to maintain essential services.

### **3. Two weak links in the reforms: employment and social equity**

The backlog of social needs that accumulated during the earlier phase of growth swelled with the addition of the after-effects of the crisis, which included lower wages, rising unemployment and increases in other forms of under-utilization of the labour force, mounting inequalities and the expansion of poverty.

The subsequent reactivation of the economy provided only partial remedies for these after-effects. What is more, the types of changes made in the region's production structures following the adjustment process, modifications in relative prices and trade liberalization initiatives have not yet generated a suitable rate of job creation or a sufficient reduction in existing inequalities. In fact, in many countries, indicators of social equity have still not returned even to their pre-crisis levels.

On the one hand, the changes now taking place create a risk of greater polarization between those segments of the labour force that are benefiting from the technological progress being made by the more dynamic types of activities and those that eke out a subsistence from low-productivity jobs; on the other hand, these same changes open up opportunities for the creation of the types of productive jobs and higher wage levels associated with rapid economic growth processes that can galvanize the production apparatus.

Thus far, there have been more signs of the first type of effect. The structural heterogeneity characteristic of the region's production apparatus has been heightened in recent years as the region witnesses a widening of productivity differentials between large firms at the forefront of the modernization process

and the varied group of activities that have fallen behind in that process. At the macroeconomic level, this dichotomy is manifested in a low rate of job creation for high-productivity positions and in the fact that a growing percentage of the labour force is either working in low-productivity positions or is unemployed. In a parallel development, the gap between the wages of more highly educated workers and less qualified workers is tending to widen.

The reductions in social spending and in the quality of social services made as part of the fiscal adjustment of the 1980s (ECLAC, 1994a) have, among other consequences, had an impact on social policies whose objective has been to alleviate the most serious effects of deprivation and marginality but whose results have so far been insufficient and of limited effectiveness.

## II. EVOLUTION OF SAVING AND INVESTMENT

### A. OVERVIEW

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During the 1980s, to one degree or another depending on the country, rates of saving and rates of investment in particular dropped sharply in comparison with previous decades. Although saving and investment ratios have been rising gradually in the 1990s, in most countries they have still not regained pre-crisis levels.

The following conclusions can be drawn from studies conducted on this topic:<sup>16</sup>

i) The level of national saving improves in a favourable macroeconomic and institutional context. Consistent macroeconomic policies contribute to increasing non-inflationary domestic financing and enable the foreign exchange, money and goods markets to send stable signals leading, over time, to an efficient allocation of resources. Progress in institutional development can strengthen the efficiency of financial systems in attracting, coordinating and allocating resources, while ensuring that they are supervised and regulated in accordance with the highest standards.

ii) While interest rates do not have a decisive influence on the volume of

savings, they contribute to a more efficient use of available resources and to control of capital movements.

iii) A variety of data exists concerning the trade-off between public and private saving which strengthens the view that there is a need for greater complementarity between the two types of saving.

iv) Efforts to promote saving may be fruitless if external conditions place major constraints on growth. For example, transfers of resources abroad, generated by external debt, consumed a high proportion of the income which would otherwise have been available as savings, thus reducing the level of investment necessary to ensure sustainable economic growth.

v) Devaluation has had an ambiguous effect on public saving, depending on whether governments could derive benefits from it or whether public accounts were adversely affected by it.

vi) Given the fiscal and balance-of-payments constraints caused by external debt, the resumption of external financing could enhance the efforts to promote national saving; in practice, however, such financing frequently leads to an excessive rise in consumption at the expense of saving.

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<sup>16</sup> Including two surveys carried out by ECLAC: Massad and Eyzaguirre (1990) and Held and Uthoff (1995).

## B. SAVING

As figure II.1 shows, regional saving displays three main characteristics: i) stabilization at a rate roughly equivalent to 20% of GDP; ii) a tendency towards an increase in external saving which displaces national saving; and iii) a partial displacement of private saving by public saving.

The macroeconomic context influences national saving by determining the level and composition of disposable real income and by strengthening the financial system. Saving and investment incentives should be part of two key efforts: i) implementing an economic policy that offers stability and appropriate incentives for investment and growth and sets goals and prices that contribute to an efficient and competitive assignment of resources; and ii) strengthening the financial system, so that it can provide guarantees of solvency, circumspection and sound management in the handling of third-party resources.

As the current situation makes clear, conflicts have emerged in the region between different sources of saving. The increase in public saving has, to a large extent, offset the decline in private saving. The increase in real disposable income, meanwhile, resulting from a higher influx of external savings, which has softened the external constraints, has been channelled disproportionately into consumption, displacing all forms of national saving.<sup>17</sup>

Gross national saving as a percentage of GDP (at current prices) held relatively steady from 1974 to 1981, during which time high international liquidity levels gave countries access to external financing, specifically bank loans.<sup>18</sup> Later,

when the debt crisis occurred, and economic activity began to be adjusted in response to the suspension of external financing, national saving decreased.<sup>19</sup>

The rate of saving subsequently rose again, in response to the recovery of per capita disposable income, although the upward trend was disrupted when the region regained access to external capital at the start of the 1990s (see table II.1).

National saving, calculated at current prices, shows constant fluctuations from 1980 onward, which are due to large variations in real disposable income. One of the consequences of the debt crisis was the marked decline in this variable and in national saving in the countries of the region. The national savings rate fell from 21% to 17.8% of GDP from 1980 to 1982 and only reached 18.7% of GDP during 1983-1986, after which (in 1987-1989) it returned to its original level, mirroring the rise in per capita real disposable income.

The resumed flow of international capital into the region at the start of the 1990s again undermined national saving. In fact, national saving stabilized again, only to decrease markedly, while external saving began to increase. Table II.2 shows that, under certain circumstances, the strengthening of public finances through increased public saving has had a high cost in terms of private saving.

### 1. Macroeconomic determinants of national saving

Table II.2 shows the relative importance of the chief determinants of the gross national savings ratio among a broad sample of countries in the region for the period 1970-1990. The level of real per

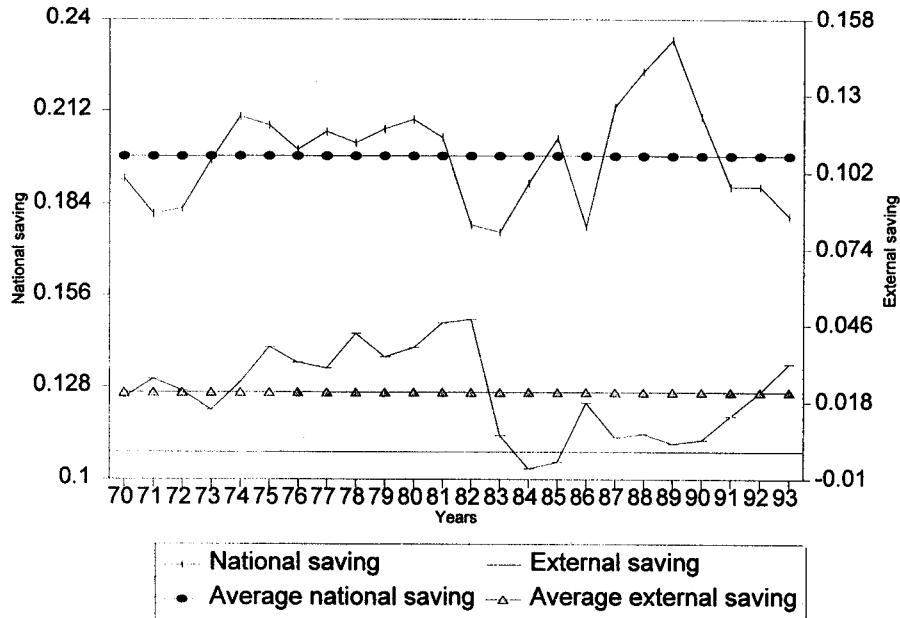
<sup>17</sup> Held and Uthoff (1990) analyse the measurement, the determinants and the effects of saving in the countries of the region.

<sup>18</sup> External saving is equal to the inflow of capital in its various forms (foreign direct investment, portfolio investment, external credits and transfers on capital account), less the reserves accumulated by the central bank.

<sup>19</sup> Under these circumstances, the fulfilment of international commitments had three consequences: a drop in GDP, as the level of activity adapted to the availability of external resources; a sharper reduction in disposable income, resulting from the need to allot a higher proportion of GDP to debt service; and, lastly, a lesser inclination to save in the various countries.

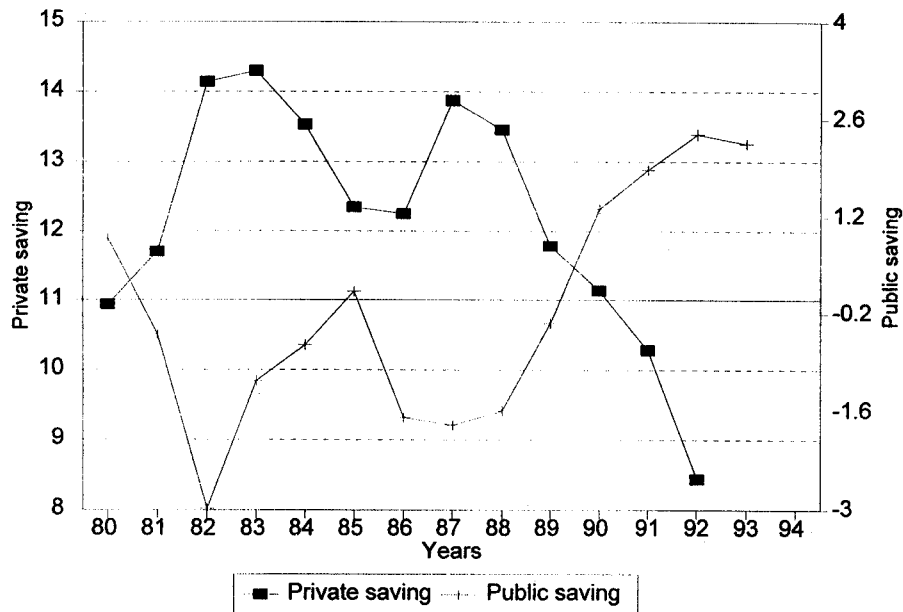
Figure II.1  
LATIN AMERICA AND THE CARIBBEAN: EVOLUTION OF SAVING

NATIONAL SAVING AND EXTERNAL SAVING  
at current prices (% GDP)



Source: ECLAC, on the basis of official figures for 15 countries.

PRIVATE SAVING AND PUBLIC SAVING  
at current prices (% GDP)



Source: ECLAC, on the basis of official figures for 12 countries.

Table II.1  
**LATIN AMERICA AND THE CARIBBEAN: INDICATORS OF  
 SAVING AND CAPITAL FORMATION**  
*(Percentages)*

Period	DNY	GNS	ES	GCF	PGCF/ PGDP	GCF'
1970-1973	1385	18.8	2.1	20.9	1.16	18.0
1974-1975	1647	20.9	3.2	24.1	0.97	24.9
1976-1979	1809	20.4	3.5	23.9	1.00	24.0
1980-1981	1967	20.7	4.3	24.9	1.02	24.5
1982	1821	17.8	4.9	22.6	1.09	20.8
1983-1986	1757	18.7	0.3	19.0	1.14	16.7
1987-1989	1808	22.4	0.4	22.8	1.31	17.4
1990-1991	1786	20.0	0.9	20.8	1.28	16.3
1992-1993	1793	18.5	2.7	21.1	1.17	18.1

Source: ECLAC, on the basis of official data. Countries considered: Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Panama, Paraguay, Peru, Uruguay and Venezuela.

- DNY = Per capita disposable national income (in 1980 dollars).  
 GNS = Gross national saving at current prices.  
 ES = External saving at current prices (current-account balance).  
 GCF = Gross capital formation at current prices.  
 PGCF/  
 PGDP = Relative price of gross capital formation.  
 GCF' =  $GCF/(PGCF/PGDP)$ .

capita income and its growth rate are among the chief determinants of this ratio. Nevertheless, the results indicate that saving is not very responsive to changes in these variables, despite their statistical significance, and that, contrary to the postulates of the permanent-income theory or the life-cycle theory, economic agents in the region do not discriminate between permanent and temporary income. A large number of income variations are viewed as permanent and thus influence these agents' short-run consumption levels.

The regressions in table II.2 indicate that cyclical variations in income tend to have a positive but small impact on saving and therefore a large impact on consumption.<sup>20</sup> This result reflects the fact

that in the experience of the region as a whole, external or internal shocks which generate "temporary" increases in income have a positive impact on consumption levels, implying the possibility of overadjustments in this variable, with the resulting drop in national saving.

Two factors can account for this behaviour. First, there are indications that economic agents in the region frequently face liquidity or credit constraints (Schmidt-Hebbel, Webb and Corsetti, 1992). Under these circumstances, consumption, due to its overresponsiveness, reacts to temporary fluctuations in income (Flavin, 1981; Hall and Mishkin, 1992). Second, the strong reaction of consumption to variations in income may be due to "repressed consumption".

<sup>20</sup> The fact that very little is saved from temporary income suggests a marginal non-zero propensity to consume, which is contrary to the permanent-income hypothesis. While a deviation in income from its trend level has a positive influence on saving, the savings ratio is in the range of 0.2%, which indicates that in order to increase saving by 1% of GDP, observed income must exceed its trend level by an amount equal to 5%.

Table II.2  
**DETERMINANTS OF GROSS NATIONAL SAVING: EFFECTS OF THE CYCLE  
 AND TREND IN INCOME AND EXTERNAL SAVING**

Estimating technique	Independent variables									Adjusted R <sup>2</sup>
	Con- stant	Per capita income (In logarithm)		In- flation	Growth	Age de- penden- cy ratio	Terms- of- trade effect	External saving (Percentage of GDP)		
		Trend	Trend deviate					Trend	Trend deviate	
1. Fixed effects, including Brazil and Peru		0.05 (3.9)	0.21 (12.6)	0.001 (2.7)	0.18 (4.5)	-0.02 (0.7)	-0.25 (7.8)	-0.10 (0.9)	-0.53 (11.6)	0.69
2. Fixed effects, excluding Brazil and Peru	0.08 (4.6)	0.08 (3.5)	0.21 (11.8)	-0.0005 (0.1)	0.21 (4.6)	0.003 (0.1)	-0.25 (7.4)	-0.09 (0.7)	-0.52 (10.9)	0.75
3. Random effects, excluding Brazil and Peru	0.11 (6.1)	0.05 (7.3)	0.25 (13.3)	0.002 (3.5)	0.16 (3.4)	0.10 (4.7)	-0.29 (8.7)	-0.31 (3.4)	-0.50 (10.0)	0.76
4. Random effects, excluding Brazil and Peru		0.06 (10.8)	0.24 (11.2)	-0.024 (3.3)	0.20 (3.96)	0.06 (3.3)	-0.129 (3.1)	-0.19 (2.0)	-0.53 (7.9)	0.82

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

Note: T-statistics shown in brackets.

Given the low levels of per capita income, especially during the 1980s, increases in income have largely been allotted to increasing consumption.<sup>21</sup>

## 2. External saving and national saving

A second striking aspect of the estimates shown in table II.2 is the adverse impact which the level of external saving had on national saving and the fact that this impact was greater if external saving rose above its trend value. The negative response of national saving to cyclical variations in external saving implies that the types of linkages which exist with the international financial markets have an

important influence on national savings levels.

These equations show that a 1% increase in external saving over its trend level reduces national saving by around 0.5% of GDP. Moreover, external saving has replaced national saving to a far greater extent in those countries which regained access to international capital markets at the start of the 1990s. As a result, they adopted macroeconomic policies that have resulted in significant overspending in relation to national income, and have relied on growing appreciations in the exchange rate as a means of stabilization. These characteristics have been especially notable in those countries which had to repress their consumption during the

21 The estimates in table II.2 analyse other factors which also influence the proportion of disposable income allotted to saving: i) the age structure of the population. A higher dependency ratio should be accompanied by a lower savings rate, since dependants are not, in principle, capable of saving; ii) inflation, given its effect on the expectations regarding real rates of return on financial instruments; and iii) the terms-of-trade effect on real income. Nevertheless, the statistical results derived from these estimates are either negligible, as in the case of the first two factors, or do not confirm the theoretical assumptions, as in the third case. A more precise measurement of the influence of this last factor would require further refinement of the model used in preparing the estimates.

1980s because they did not have access to external financing during their phases of adjustment to the external debt crisis.

Moreover, the rapid influx of financial capital has not been reflected in the creation of productive assets; rather, a wealth effect has been produced as a result of a rapid appreciation in the price of existing assets. Thus, the capital inflows translated into higher trends towards consumption.

The countries of the region which increased their disposable national income from 1990 to 1993, with current-account deficits that were relatively moderate and, in some cases, lower than during 1983-1986 and with equally moderate exchange-rate appreciations (e.g., Chile and Costa Rica),<sup>22</sup> have maintained relatively high levels of national saving. At the other end of the spectrum are the countries that have widened their current-account deficits excessively, relied on exchange-rate appreciations as a means of stabilization, and have been unsuccessful in their efforts to increase national saving (Argentina, Colombia, Mexico, Paraguay, Peru and Venezuela). Ecuador occupies a middle ground.

### 3. Public saving and private saving

In the countries which have partially overcome the stabilization dilemma (Colombia and Chile), public and private national saving has responded favourably to the recovery in the level of activity following the debt crisis. It should be noted that these economies received external financing in at least one, if not both, phases of the adjustment process, which enabled them to reduce their current-account deficits markedly. In these two countries, the replacement of

private saving by public saving and of national saving (public and private) by external saving was minimal, owing to the level and steadiness of prices, which were used as incentives for the funding of activities to promote growth and investment.

The economies which not only took steps to deal with the debt crisis, but also placed particular emphasis on stabilization (Mexico up to 1994, Costa Rica, El Salvador and Guatemala) achieved less impressive results, with the exception of Costa Rica, which reduced its traditional dependence on external financing. In these cases, there is evidence that the strengthening of public finances, as reflected in the increase in public saving or the decrease in public dissaving, has been detrimental to private saving, already undermined by the higher influx of external saving during the periods in which economic policy was based on current-account deficits similar in size to those seen prior to the debt crisis, as in Mexico<sup>23</sup> and El Salvador.

In the countries with persistently high inflation rates, especially Uruguay, rates of saving have not yet regained their pre-crisis levels. In comparison with that period, public saving has not increased, except in Ecuador during the second adjustment phase. This is not so much a function of high current-account deficits as of the problems posed by the strengthening of public finances and the feebleness of the economic recovery.

Lastly, in the countries which experienced very high inflation or hyperinflation, rates of saving either remained at the same level as before the crisis (as in Brazil), or decreased (as in Argentina and Peru). In Argentina, the largest decrease in saving occurred following the first adjustment phase, in

22 It should be noted that both countries received major external financial support in adjusting their economies to the impact of the debt crisis.

23 The conflict among various types of saving was very significant in the case of Mexico, which did not have access to net external financing in any of the successive adjustment phases. Accordingly, once the influx of private capital resumed, the country adopted a new policy approach which meant excessive dependence on external financing.

Table II.3  
**LATIN AMERICA AND THE CARIBBEAN (12 COUNTRIES): NATIONAL SAVING<sup>a</sup>  
 AND EXTERNAL SAVING IN DIFFERENT MACROECONOMIC PHASES**  
*(Percentage of GDP)*

Country	Phase	End of period of external credit abundance 1980-1981	Adjustment of spending			Recovery		Resumption of capital inflows 1992-1994
			1982	1983- 1984	1985- 1986	1987- 1989	1990- 1991	
<b>Stabilized economies</b>								
Colombia	National saving	18.2	15.1	15.1	19.5	21.5	22.0	18.0
	Private saving	15.2	12.6	12.9	13.6	16.5	15.2	10.0
	Public saving	3.0	2.5	2.2	6.0	5.0	6.9	8.0
	External saving	1.6	5.4	4.3	-1.0	-0.8	-4.8	1.3
Chile	National saving	11.2	3.1	7.2	9.7	21.1	24.2	24.7
	Private saving	-1.9	-2.2	5.0	8.1	15.2	18.3	19.5
	Public saving	13.1	3.1	2.2	1.5	5.9	5.9	5.2
	External saving	11.2	9.8	8.6	8.4	2.4	1.2	2.8
<b>Economies which have made progress towards stabilization</b>								
Mexico	National saving	21.8	22.4	23.6	20.3	20.0	18.5	15.6
	Private saving	21.0	30.1	27.9	27.3	27.4	17.6	13.0
	Public saving	0.8	-7.7	-4.4	-7.0	-7.4	0.9	2.6
	External saving	5.5	0.5	-3.3	-0.5	0.3	3.6	6.9
Costa Rica	National saving	12.8	12.4	14.6	19.9	18.1	20.6	22.2
	Private saving	13.9	10.6	12.2	15.8	13.9	17.5	18.4
	Public saving	-1.9	1.8	2.3	4.1	4.2	3.1	3.7
	External saving	15.0	12.3	8.9	5.7	8.0	5.6	6.8
El Salvador	National saving	11.0	10.8	9.3	11.5	13.8	10.6	15.5
	Private saving	12.0	13.4	11.4	10.7	14.6	11.1	14.5
	Public saving	-1.0	-2.6	-2.1	0.8	-0.8	-0.6	1.0
	External saving	2.7	2.5	2.8	0.5	-0.3	2.2	1.0
Guatemala	National saving	12.0	9.6	8.1	8.7	8.3	11.1	11.4
	Private saving	11.7	9.3	8.5	8.6	8.6	10.7	9.9
	Public saving	0.4	0.3	-0.5	0.1	-0.3	0.4	1.5
	External saving	4.4	4.6	3.3	2.2	5.4	2.9	6.2
<b>Economies with persistently high inflation</b>								
Ecuador	National saving	20.2	15.8	14.7	15.0	12.3	17.5	18.7
	Private saving	14.0	12.0	6.8	5.0	9.9	11.1	12.1
	Public saving	6.2	3.8	8.0	10.0	2.4	6.4	6.6
	External saving	4.4	9.4	2.7	4.5	9.3	2.3	2.3
Uruguay	National saving	17.6	15.2	10.5	11.2	13.3	14.0	12.4
	Private saving	13.6	18.9	10.1	8.9	12.1	9.5	8.1
	Public saving	4.0	-3.7	0.3	2.3	1.2	4.5	4.3
	External saving	5.8	5.4	2.7	0.1	-0.4	-1.7	1.4
Venezuela	National saving	nd	na	22.4	20.3	20.5	23.6	16.1
	Private saving	nd	na	9.7	8.1	13.0	12.4	9.9
	Public saving	nd	na	12.7	12.2	7.5	11.2	2.7
	External saving	nd	na	-6.9	-0.6	1.4	-9.1	5.1

Table II.3 (concluded)

Country	Phase	End of period of external credit abundance 1980-1981	Adjustment of spending			Recovery		Resumption of capital inflows 1992-1994
			1982	1983-1984	1985-1986	1987-1989	1990-1991	
<b>Economies with hyperinflationary episodes<sup>b</sup></b>								
Argentina	National saving	22.3	22.1	20.8	18.2	18.2	16.8	15.7
	Private saving	27.3	30.9	27.7	22.4	22.1	19.1	15.2
	Public saving	-5.0	-8.8	-6.9	-4.2	-3.9	-2.3	0.5
	External saving	1.7	-0.4	-0.4	-0.6	0.2	-2.0	2.7
Brazil	National saving	19.3	16.6	16.2	19.1	25.2	20.6	20.5
	Private saving	17.9	17.8	18.3	20.9	26.8	18.4	21.0
	Public saving	1.4	-1.2	-2.1	-1.8	-1.7	2.3	-0.5
	External saving	5.0	6.0	1.8	1.1	-0.3	0.6	-0.4
Peru	National saving	24.2	23.4	19.8	19.8	20.8	20.5	17.1
	Private saving	22.6	23.4	20.5	18.1	24.5	20.8	14.2
	Public saving	1.6	0.0	-0.8	1.7	-3.7	-0.3	2.9
	External saving	5.3	7.9	3.1	2.4	2.4	0.1	5.0

Source: ECLAC, on the basis of official figures at current prices, expressed as a percentage of GDP.

<sup>a</sup> National saving includes public and private saving and external saving correspond to balance-of-payments current-account balance. <sup>b</sup> Argentina from 1988 to 1990; Brazil from 1987 to 1994; and Peru from 1988 to 1990.

which the successive increases in public saving had a disproportionate effect on private saving, a process which culminated in a marked displacement of private saving by external saving from 1992 to 1994. The same was true in Peru. In Brazil, however, there is no clear evidence of an increase in public saving, but private saving shows a high degree of responsiveness to the level of external saving.

### C. INVESTMENT

Falling growth rates and the decrease in domestic demand stemming from the debt crisis were reflected in an

underutilization of productive capacity and a marked decline in investment. While these conditions were widespread, the magnitude of the adjustment and the subsequent recovery varied considerably from one country to the next. As early as 1985-1989, for instance, Chile, Colombia and the Dominican Republic managed to exceed the level of investment for the period 1978-1981 (see table II.4).

As some studies carried out in the region have shown,<sup>24</sup> capital accumulation depends to a large extent on each country's initial level of indebtedness, the evolution of the terms of trade, the relative amount of external financing received during the adjustment process and the degree of liberalization of the economy.

<sup>24</sup> Summaries of these studies can be found in the following publications: Servén and Solimano (1993a); Bacha (1993); Damill and Fanelli (1994) and Schmidt-Hebbel, Servén and Solimano (1994).

Table II.4  
LATIN AMERICA AND THE CARIBBEAN (17 COUNTRIES):  
EVOLUTION OF GROSS FIXED CAPITAL  
FORMATION AND GDP 1978-1994

	Gross fixed capital formation <sup>a</sup> (Indexes 1978-1980 average =100)				GDP <sup>a</sup> (Average annual variation for the period)				Gross fixed capital formation as a percentage of GDP <sup>b</sup>			
	1978-1981	1982-1984	1985-1989	1990-1994	1978-1981	1982-1984	1985-1989	1990-1994	1978-1981	1982-1984	1985-1989	1990-1994
Argentina	97	73	67	82	0.3	0.9	-0.9	6.1	24.0	18.1	16.2	19.0
Bolivia	95	52	68	81	0.4	-3.1	1.3	4.0	16.6	9.9	13.3	14.3
Brazil	99	80	94	84	4.4	1.1	4.5	1.0	22.5	17.5	17.0	15.5
Chile	111	82	130	229	7.2	-3.1	6.1	5.7	17.4	14.0	17.8	22.3
Colombia	104	121	128	157	5.0	2.2	4.8	4.0	16.3	17.6	15.6	16.0
Costa Rica	93	61	90	135	2.3	1.1	3.8	4.7	24.5	16.5	21.3	24.5
Ecuador	99	79	76	80 <sup>c</sup>	5.3	0.7	2.2	3.3	23.2	17.2	15.2	14.1
El Salvador	92	57	72	91 <sup>c</sup>	-3.2	-0.9	1.5	4.2	15.2	11.2	13.3	16.6
Guatemala	100	70	66	85 <sup>c</sup>	3.7	-2.0	2.2	3.8	13.5	9.5	8.6	9.7
Honduras	95	74	78	113 <sup>c</sup>	5.2	0.5	3.9	2.6	24.5	18.2	16.9	21.9
Mexico	109	92	86	119	9.2	-0.4	1.1	3.0	23.9	18.6	17.2	20.8
Panama	108	111	84	120 <sup>c</sup>	8.3	1.6	-1.1	6.5	21.4	18.7	13.6	17.8
Paraguay	110	102	106	135 <sup>c</sup>	10.5	-0.2	4.2	2.9	25.8	21.4	19.9	21.4
Peru	109	104	89	89	3.9	-2.3	-0.2	2.8	22.9	22.0	17.6	19.7
Dominican Republic	100	87	114	129 <sup>c</sup>	4.0	2.2	4.4	1.8	22.5	22.0	21.6	21.1
Uruguay	102	66	49	71	4.9	-5.5	3.9	3.7	17.2	12.7	9.7	12.5
Venezuela	96	64	55	60	-1.1	-2.7	1.7	3.8	29.2	20.1	15.9	16.1

Source: ECLAC, on the basis of official figures.

<sup>a</sup> In 1980 dollars.

<sup>b</sup> Rate in constant local currency.

<sup>c</sup> Average for 1990-1993.

The overall coherence of economic policy and its consistency with the reforms adopted also, of course, influence the trends in capital formation.

Countries such as Colombia, Paraguay and the Dominican Republic, which at the outset of the external debt crisis had a low level of indebtedness and a small trade imbalance, and were therefore less vulnerable to external financial turbulence, were able to cope with the deteriorating external situation through gradual and moderate adjustment policies which did not lead to a sudden drop in output and investment.

Highly indebted countries, however, had to face not only the problem of

external credit constraints, but also that of high external debt service, which together reduced their financing and income opportunities and led to a contraction in domestic demand. In the case of the less industrialized countries, the constraints placed on their import capacity by a lack of foreign exchange forced them to reduce their purchases of machinery and equipment, and thus investment, to a considerable degree (see table II.8).

### 1. Determinants of investment

According to the empirical studies available,<sup>25</sup> the investment decisions of

25 A useful summary appears in Servén and Solimano (1993a).

the region's private sector depend not only on the factors traditionally emphasized by theoretical approaches,<sup>26</sup> but also on specific factors relating to the context in which firms operate, such as the stability of policies, the characteristics of the financial markets and agents' level of confidence and access to the appropriate infrastructure.

One of the characteristics of the macroeconomic context which has influenced investment decisions and, in turn, clearly sets it apart from the context in which the developed countries operate, is the instability of basic prices—exchange rates, interest rates and consumer prices. According to the studies cited, entrepreneurs, being risk-averse, base their investment decisions on both the mean and the variance of the variables which affect the profitability of their investments. The stability and predictability of the system of incentives appear to be at least as important as their level.

This circumstance underscores the importance of macroeconomic stability and of clear and constant rules if entrepreneurs are to respond positively to new policies. Accordingly, bad timing and inconsistencies in economic policy or between various reforms which have affected the stability and predictability of relative prices may have influenced the slowness with which investors have responded to the new incentives.

The current literature emphasizes the importance of risk and the irreversibility of investments due to the major losses which the transfer of capital to another activity implies.<sup>27</sup> This causes investors to delay their decisions, especially if macroeconomic conditions and policies are unstable. The greater the degree of uncertainty, the greater the benefits to be gained by waiting, and, accordingly, the

slower the response by investors to an improvement in macroeconomic conditions.

The considerable, and in some cases, extreme price instability which some of the region's countries have experienced is reflected in the coefficients of variation in the consumer price index (CPI), real exchange rates and interest rates, which are shown in table II.5 for the period 1978-1994. For all of the countries analysed, the subperiods 1982-1984 and 1985-1989 show a strong increase in these coefficients, which have been influenced, especially in the later period, by the hyperinflationary situations in Argentina, Brazil and Peru in the late 1980s. From 1991 to 1994, however, a slow-down in inflation, and particularly in real exchange rates, was seen in a growing number of countries.

It is also clear that the variability of real interest rates has remained well above that of the CPI or real exchange rates in all countries; this factor, added to very high rates in some countries (see table II.6), contributed to discouraging investment projects, by making investment viable only in the case of highly profitable projects that were located in monopolistic markets or had tied financing.

The studies also underscore the importance of three price ratios. Two of them (the terms of trade and real share prices) are linked to the profitability of investments. The third is linked to the cost of capital, measured either by the relative price of gross domestic investment in relation to the implicit GDP price deflator or by the real exchange rate index, which influences the cost of imported machinery and equipment.

The drop in the terms of trade had a general impact on all the countries of the region, adversely affecting the process of capital accumulation, given its strong

<sup>26</sup> The income accelerator, in the Keynesian approach, to which, in the neoclassical framework, the relative factor price is added, or in the Tobin  $q$  theory approach, the ratio between the shadow price of an additional capital unit and its market price.

<sup>27</sup> See, in this context, Dixit (1989, 1991 and 1992), Pindyck (1988, 1991 and 1993) and Pindyck and Solimano (1993).

Table II.5  
**INSTABILITY INDICATORS**  
*(Variation coefficients)*

	Consumer price index				Real exchange rate				Real interest rate			
	1978-1981	1982-1984	1985-1990	1991-1994	1978-1981	1982-1984	1985-1990	1991-1994	1978-1981	1982-1984	1985-1990	1991-1994
<b>Stabilized economies</b>												
Colombia	0.11	0.07	0.09	0.04	0.03	0.02	0.03	0.04	0.80	0.23	0.39	0.29
Chile	0.18	0.28	0.15	0.12	0.05	0.09	0.03	0.03	0.41	0.55	0.66	0.86
<b>Economies which have made progress towards stabilization</b>												
Mexico	0.05	0.19	0.17	0.09	0.04	0.09	0.05	0.03	...	0.72	0.59	1.15
Costa Rica	0.22	0.33	0.18	0.14	0.08	0.06	0.02	0.02	0.33	2.26	0.23	0.21
Bolivia	0.24	0.44	0.49	0.08	0.06	0.31	0.13	0.01	0.26 <sup>b</sup>	0.45	0.01 <sup>a</sup>	0.19 <sup>c</sup>
<b>Economies with persistently high inflation</b>												
Ecuador	0.11	0.29	0.13	0.12	0.03	0.05	0.07	0.04	0.36	1.65	3.68	2.19
Venezuela	0.16	0.16	0.25	0.09	0.04	0.06	0.11	0.05	...	...	0.58	0.39
Uruguay	0.13	0.19	0.08	0.09	0.06	0.11	0.04	0.04	3.03	0.38	0.24	0.14
<b>Economies with hyperinflationary episodes<sup>e</sup></b>												
Argentina	0.11	0.18	0.52	0.47	0.14	0.15	0.17	0.04	0.15 <sup>b</sup>	1.13	2.25	0.33
Brazil	0.09	0.08	0.33	0.34	0.04	0.04	0.04	0.07	0.68	0.81	1.00 <sup>d</sup>	1.18
Peru	0.10	0.10	0.44	0.40	0.05	0.04	0.18	0.05	...	...	0.53 <sup>a</sup>	1.35

Source: ECLAC, on the basis of official figures.

<sup>a</sup> 1986-1990 average.

<sup>b</sup> 1980-1981 average.

<sup>c</sup> 1991-1993 average.

<sup>d</sup> 1985-1989 average.

<sup>e</sup> Argentina and Peru from 1988 to 1990; and Brazil from 1987 to 1994.

association with the variability of private investment.<sup>28</sup>

The drop in the prices of export goods reduced export earnings and thus the incentives for investing in export activities. Where such activities were closely linked to the rest of the economy, the entire process of cumulation on a global basis was affected by these conditions. In some cases where the public sector was the owner of exportable natural resources (Chile, Mexico, Ecuador, Venezuela), price instability caused an unforeseen budget deficit, which, in

general, resulted in a lower level of public investment, given the greater rigidity of current spending.

Real currency devaluation was a central feature of the adjustment policies adopted in response to the external debt crisis. While this measure stimulated the export sectors, it discouraged investment in other sectors of the economy, by increasing the cost of imported machinery and equipment and thus the cost of capital, especially in countries which do not manufacture such investment goods. Moreover, firms whose debts were

<sup>28</sup> In this connection, Cardoso (1993), through panel regressions which include data on Argentina, Brazil, Chile, Colombia, Mexico and Venezuela for the periods 1970-1973, 1974-1977, 1978-1981 and 1982-1985, concludes that the drop in the terms of trade accounts for a major share of the variance in the ratio of private investment to GDP.

Table II.6  
RELATIVE PRICE INDICATORS

	Real exchange rate indices (1978-1980 average =100)			Coefficient of investment and GDP <sup>b</sup> deflators (indices: 1978-1980 average =100)					Real interest rates (percentages) <sup>a</sup>			
	1978-1981	1982-1984	1985-1990	1991-1994	1978-1981	1982-1984	1985-1990	1991-1994	1978-1981	1982-1984	1985-1990	1991-1994
Argentina	92.5	144.8	129.4	48.8	100	104	97	86	17.7	61.9	39.7	33.9 <sup>c</sup>
Bolivia	90.5	71.8	82.7	76.9	100	117	87	100	-11.2	-53.0	-12.2	32.2
Brazil	97.2	107.6	91.9	52.3	100	116	131	...	-13.3	20.6	99.8	<sup>c</sup>
Chile	91.6	91.3	115.4	83.4	100	105	105	107	17.7	25.5	9.2	9.8
Colombia	94.7	78.1	107.0	93.9	100	98	114	110	2.4	6.3	6.2	8.7
Costa Rica	114.1	127.9	106.7	88.9	100	127	100	95	-17.0	-8.9	11.8	13.8
Ecuador	94.1	80.2	110.5	98.7	100	103	128	135	-5.6	-10.6	-7.4	-1.1
Mexico	91.8	94.7	85.4	50.3	100	103	110	96	...	-12.8	-2.1	5.6
Peru	92.0	72.5	48.0	17.9	100	112	126	...	...	...	...	27.1
Uruguay	90.6	98.8	97.6	56.2	100	101	113	106	10.3	27.6	18.9	29.0
Venezuela	93.0	72.6	101.7	94.4	100	87	98	94	...	...	-13.6	-2.1

Source: ECLAC database, on the basis of official figures provided by each country.

<sup>a</sup> ECLAC, calculated as averages of monthly figures taken from International Monetary Fund (IMF), *International Financial Statistics*.

<sup>b</sup> Deflators taken from national accounts.

<sup>c</sup> The figures for Argentina exclude 1990 due to hyperinflation; for Brazil, no figures are shown, because they do not reflect the actual rate that enterprises were charged.

denominated in foreign currency saw the financial cost of their debt rise rapidly.

In more highly industrialized countries with less open economies (such as Brazil, Mexico and Colombia), the effects of devaluation were compounded by those of other policies which also increased the costs of capital goods, such as temporary tariff increases or higher profits taxes. In these countries, furthermore, the drop in domestic demand reduced the output of capital goods, leading to a severe under-utilization of capacity in that sector, which transferred the impact to prices.<sup>29</sup>

During 1982-1984 there was a general increase in the price of capital goods relative to all other prices in the economy.

In most cases this trend continued or deepened during the rest of the 1980s, as shown by the ratio between the implicit prices of gross capital formation and of GDP (see table II.6). During the 1990s, this ratio fell below the 1978-1980 levels in only half of the countries considered.

Moreover, in many countries of the region, expectations of devaluation and uncertainty about the future stimulated a rise in domestic interest rates, increasing the discrepancy between domestic and international interest rates and causing the real value of capital to fall, which also discouraged private investment.<sup>30</sup>

The relative amount of external financing received by each country during the adjustment period had a key influence

<sup>29</sup> In the case of Brazil, Carneiro and Werneck (1993) show that the relative price of investment in machinery and equipment increased by 42% in relation to the GDP deflator from 1986 to 1989; they attribute this behaviour to a major drop in capacity utilization in the capital goods-producing sector and to the high protective barriers established during that period.

<sup>30</sup> Cardoso (1993) reconciles the Mundell-Fleming and Dornbusch (1976) models to show the mechanisms by which an external shock is transmitted to the real value of invested capital.

on the capacity of the economy to control and limit macroeconomic disequilibria. The orderly financing of external disequilibria was an important factor in the expectations of agents and reduced their degree of uncertainty, an essential element in investment decisions. A few countries received either support from multilateral institutions (like Chile) or unilateral transfers of resources (like Costa Rica), which not only enabled them to restructure their debts to international private banks, but also gave them access to external credits so that they could increase their imports. Studies of private investment in the region show that the availability of external financing was, in fact, a significant factor.<sup>31</sup>

Moreover, the depth of the financial markets –specifically, the availability of long-term credits and the manner in which credit is allocated, i.e., by the market or in a managed way– have also been decisive for private investment in Latin America and the Caribbean.

## 2. Impact of macroeconomic factors on productive investment

In order to assess the impact of macroeconomic factors on investment, the productive investment (machinery and equipment) function, measured in terms of its ratio to GDP, was estimated for the period 1970-1994 in eight countries selected on the basis of their available data.

The exercise was conducted by means of a partial adjustment model, which has traditionally been used to illustrate the dynamic of an adjustment process aimed at achieving a desired capital stock. The explanatory variables are the following: i) those related to the income accelerator effect, i.e., variation in GDP and level of

capacity utilization (ratio of actual output to potential output); ii) relative prices, i.e., the cost of capital, an approximate index of the Tobin  $q$  and the terms of trade; iii) an instability or risk indicator, consisting of the coefficient of variability in the CPI, the real interest rate and the real exchange rate; and iv) in the absence of a suitable indicator for measuring the financial constraint, a debt-burden indicator was used (the ratio of total external debt or debt service to exports of goods and services), assuming that this indicator has an inverse relationship to the availability of private-sector financing.

In Brazil and Mexico, the relative price indicators were not significant, and such variables as the level of capacity utilization, instability and the debt burden accounted for over 90% of the variance in the productive investment ratio. In only three of the eight countries did the investment cost and yield indicators show a significant impact. Nevertheless, it was clear that the coefficients of risk have a significant adverse impact on all the countries that have gone through major periods of instability, such as Argentina, Brazil, Mexico and Peru. In the cases of Colombia, Costa Rica and Chile (beginning in 1985), it has been shown that investment was not significantly affected by the variability of basic prices.

In the countries in which the adjustment of domestic demand was sudden, sharp and prolonged, the level of capacity utilization proved to be significant and to have a greater impact on investment than relative prices did. This result was to be expected, as the countries in question faced a severe sales constraint which generated a high level of underutilization of capacity and adversely affected investment requirements. As expected, the debt burden led to a significant decrease in investment in four

<sup>31</sup> See the analyses of Uruguay by De Melo and Tybout (1986); of Colombia by Ocampo, Londoño and Villar (1988); and of a group of developing countries by Green and Villanueva (1990). These studies use various indicators of availability of external financing, i.e., exports, international reserves, capital flows and real exchange rates. As Rama (1993) indicates, these indicators may be related to the "investment climate", but not necessarily to credit rationing.

Table II.7  
ESTIMATES OF THE IMPACT OF MACROECONOMIC FACTORS  
ON PRODUCTIVE INVESTMENT

Investment in machinery and equipment/GDP	Price ratio			Demand		Debt burden	Instability	DEX(-1)	R2	D-W
	TT	Tobin $q$	CK	% GDP	UCAP					
Argentina (1971-1994)	-	-	-0.002 (-2.4)	-	-	-	-0.03 (-3.3)	0.17 (1.1)	0.71	2.1
Brazil: PRODI (1971-1994)	-	-	-	-	0.11 (3.2)	-0.04 (3.8)	-0.04 (-4.9)	0.73 (11.8)	0.97	2.1
Colombia: IMAE (1971-1994)	-	-	-0.03 (-1.9)	0.02 (3.1)	-	-	0.13 (0.19)	0.49 (3.0)	0.72 (3.0)	2.0
Costa Rica: IMAE (1971-1994)	-	-	-0.11 (-3.80)	-	0.26 (3.6)	-	-0.08 (-1.0)	0.30 (2.6)	0.91	1.96
Chile: IMAE (1971-1994)	-	0.04 (5.6)	-	-	0.06 (2.0)	-0.8 (-2.8)	-0.02 (-0.7)	0.03 (0.3)	0.94	2.0
(1971-1984)	-	0.07 (5.3)	-	-	0.07 (3.4)	-0.01 (-4.3)	-0.03 (-1.5)	-	0.90	1.9
Mexico: IMAE (1971-1994)	-	-	-	-	0.44 (7.8)	-0.15 (-1.5)	-0.04 (-2.2)	0.80 (12.6)	0.95	2.0
(1982-1994)	-	-	-	-	-	-0.06 (-1.4)	-10.0 (-2.5)	0.70 (4.9)	0.87	1.9
Peru: IMAE (1971-1994)	0.06 (2.5)	-	-	0.10 (2.6)	-	-0.07 (-1.9)	-	0.70 (9.6)	0.93	2.2
(1983-1994)	0.06 (5.2)	-	-	-	-	-	-0.04 (5.8)	0.34 (8.8)	0.99	2.0
Venezuela: PRODI (1971-1994)	0.04 (1.2)	0.58 (2.54)	-	-	-	-	-0.38 (-1.9)	0.43 (2.3)	0.78	2.0

Source: ECLAC, "Student's T" statistics are shown in brackets below the coefficients; the R2 and Durbin-Watson statistics, in the last two columns.

PRODI/GDP: Index of the ratio of productive investment (machinery and equipment + non-residential investment) to GDP (1980=100). Source: national accounts.

IMAEGDP: Index of the ratio of investment in machinery and equipment to GDP (1980=100). Source: national accounts.

TT: Index of the terms of trade: f.o.b. exports - c.i.f. imports (1980=100). Source: ECLAC.

Tobin  $q$ : Index of share prices deflated by the CPI (1980=100). Source: IMF, *International Financial Statistics*.

CK: Ratio of gross fixed capital investment deflator to GDP deflator. Source: national accounts.

% GDP: Annual variation in GDP (logarithmic difference). Source: national accounts.

UCAP: Ratio of actual output to potential output; potential output estimated according to the maximum value method (1980=100).

Deb burden: Index of the ratio of total debt to exports or debt service to exports (1980=100). Source: ECLAC.

INSTAB: Index composed of the coefficient of annual variation in the CPI, the real exchange rate and the real interest rate, based on monthly data. Source: IMF, *International Financial Statistics*.

Table II.8  
LATIN AMERICA AND THE CARIBBEAN (13 COUNTRIES): COMPONENTS OF INVESTMENT

	1978- 1981	1982- 1984	1985- 1989	1990- 1994	1978- 1981	1982- 1984	1985- 1989	1990- 1994
	<b>Indexes of volume of merchandise imports FOB</b> (1978-1980 base period = 100)				<b>Index of investment in imported machinery and equipment</b> (1978-1980 base period = 100)			
Argentina	104	67	59	127	106	99	100	112
Brazil	97	68	75	115	96	62	77	67
Chile	109	75	96	170	109	61	144	290
Colombia	104	122	110	181	104	116	116	166
Costa Rica	93	66	103	176	92	54	94	139
El Salvador	93	65	67	94	...	...	...	...
Guatemala	96	68	76	122	96	66	67	86
Honduras	97	82	104	121	94	109	58	89
Mexico	117	91	132	279	111	78	77	136
Nicaragua	106	107	103	87	137	75	170	110
Peru	112	123	106	128	112	96	59	39
Uruguay	101	61	76	132	101	49	47	81
Venezuela	799	79	80	84	97	69	75	65
	<b>Private investment</b> (Ratio to GDP in constant local currency)				<b>Public investment</b> (Ratio to GDP in constant local currency)			
Argentina	17.0	13.4	11.5	16.7	7.0	4.6	4.7	2.4
Brazil	15.1	11.9	12.1	11.2	7.4	5.6	4.9	4.4 <sup>a</sup>
Chile	8.2	7.9	9.4	16.8	7.7	5.0	6.9	5.7
Colombia	8.7	7.7	7.6	...	7.6	9.9	7.9	...
Costa Rica	15.5	9.4	12.8	15.9	9.0	7.1	8.5	8.6
El Salvador	6.8	nd	8.6	10.8 <sup>b</sup>	6.6	nd	4.0	3.7 <sup>b</sup>
Guatemala	8.7	5.7	6.1	6.9 <sup>b</sup>	4.8	3.9	2.5	2.7 <sup>b</sup>
Honduras	13.4	6.9	9.0	11.1 <sup>b</sup>	8.5	9.7	6.3	8.7 <sup>b</sup>
Mexico	13.0	11.0	12.0	16.0	11.0	8.0	6.0	5.0 <sup>b</sup>
Nicaragua	6.6	6.9	...	5.9 <sup>b</sup>	7.3	11.1	nd	8.5 <sup>b</sup>
Peru	16.6	15.3	13.4	15.7	6.3	6.7	4.2	4.0 <sup>b</sup>
Uruguay	10.8	7.3	5.9	8.9	6.4	5.5	3.8	3.6 <sup>b</sup>
Venezuela	15.8	8.2	6.9	5.9	13.4	11.9	9.0	10.3
	<b>Investment in non-residential construction</b> (Ratio to GDP in constant local currency)				<b>Investment in machinery and equipment</b> (Ratio to GDP in constant local currency)			
Argentina	7.4	3.9	2.6	2.9	7.8	7.4	7.2	7.2
Brazil	8.9	7.4	7.1	6.3	8.0	5.4	5.5	4.7
Chile	5.6	4.3	5.6	5.9	6.6	3.9	7.9	11.9
Colombia	6.4	7.3	6.6	5.4	7.4	7.7	6.6	7.6
Costa Rica	...	...	...	...	13.1	7.9	12.3	14.6
El Salvador	...	...	...	...	6.2	...	6.1	8.2
Guatemala	...	...	...	...	7.1	4.6	4.8	5.3
Honduras	...	...	...	...	10.7	4.5	5.6	6.5
Mexico	9.1	7.5	5.6	3.5	10.3	6.6	6.7	9.9
Nicaragua	...	...	...	...	8.9	13.4	12.1	8.8
Peru	...	...	...	...	10.6	9.1	5.1	4.0
Uruguay	...	...	...	...	6.4	3.4	3.5	5.1
Venezuela	11.1	8.3	5.6	6.7	12.2	9.0	8.7	7.0

Source: ECLAC, on the basis of official figures, and André A. Hofman, "Capital stock in Latin America: a 1994 update", *Cambridge Journal of Economics*, forthcoming.

<sup>a</sup> Includes investment in public enterprises. <sup>b</sup> Averages for 1990-1993 only.

Table II.9  
LATIN AMERICA AND THE CARIBBEAN (10 COUNTRIES):  
FOREIGN DIRECT INVESTMENT

	Argentina	Bolivia	Brazil	Chile	Colom- bia	Costa Rica	Mexico	Peru	Uruguay	Vene- zuela
<b>Millions of 1990 dollars</b>										
1978-1980	758	53	3 406	371	133	82	2 454	74	368	127
1982-1984	308	20	2 396	268	612	58	2 463	1	-2	151
1985-1989	826	5	1 374	814	618	94	2 271	31	28	-75
1990-1994	3 442	67	319	409	568	195	3 905	117	17	536
<b>1978-1980 (index = 100)</b>										
1978-1980	100	100	100	100	100	100	100	100	100	100
1982-1984	41	37	70	72	460	70	100	1	-1	119
1985-1989	109	10	40	220	465	114	93	42	8	-59
1990-1994	454	126	9	110	427	238	159	159	5	423

Source: ECLAC, on the basis of official figures.

of the countries most affected by the crisis (Brazil, Chile, Mexico and Peru).

### 3. Public investment

The external constraints affected public investment both directly, by limiting its financing, and indirectly, in terms of the fiscal imbalances caused by the external shocks.

As table II.8 shows, public investment as a percentage of GDP fell significantly in most countries during the 1980s. In some countries, this trend deepened still further from 1985 to 1989 and, in most cases, has not yet been reversed.

In the Central American countries, during the initial period of external crisis, public investment did not decrease as much as private investment. Later, however, during 1985-1989, the spending cuts made in the context of stabilization programmes led to a decline in the rate of public investment.

In countries where the public sector was a net consumer of foreign exchange, such as Argentina, Brazil and Uruguay, the combination of external and fiscal adjustments resulted in serious conflicts linked to the problem of domestic transfers.

In such cases, the foreign exchange used for making interest payments on the external debt stemmed either from domestic borrowing, which exerted pressure on the financial markets, or from money issues, which exacerbated macroeconomic destabilization. The devaluations necessary for achieving a trade surplus heightened the fiscal imbalance by increasing the local-currency value of interest payments on the external debt. Since public and private investment were closely linked, drastic cuts in the former had an impact on the latter. In the countries which were late in starting the adjustment process (Peru, Argentina and Brazil), the inflation rate accelerated, leading to demonetization of the economy, capital flight and heightened risk and uncertainty, which discouraged capital accumulation still further.

### 4. Upturn in foreign direct investment

Beginning in 1991, the negative trend in the external variables began to be reversed, due to the notable upturn in international capital flows to the region.

The subsequent recovery, occurring in a context of greater stability and softening of external constraints, contributed to raising investment rates. The increase in the flow of foreign direct investment (although initially slight) and the public-sector saving campaign also contributed to the higher level of investment.

The deepening of the economic reform process, the progress achieved with regard to fiscal and price stability and the liberalization of foreign capital regimes helped to create a climate conducive to the resumption of foreign direct investment flows. Table II.9 shows the trend in this

type of investment in some countries from 1978 to 1994. In the 10 countries considered, with the exception of Brazil and Uruguay, a marked increase can be seen in foreign direct investment during 1990-1994. In Peru, Argentina, Mexico and Venezuela, a large share of these resources were used for the purchase of privatized enterprises, which did not constitute capital accumulation in the receiving country. In Colombia, Chile and Costa Rica, however, the direct investment made during the past five years has largely contributed to the expansion of productive capacity.



### III. PRODUCTIVE RESTRUCTURING AND TECHNOLOGICAL PROGRESS

#### A. CHANGING PRODUCTION PATTERNS IN LATIN AMERICA AND THE CARIBBEAN

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Between 1950 and 1980, growth in the region was faster than in industrialized countries, with the exception of Japan. Ultimately, this performance can be attributed to a growth pattern based on higher input of capital, and also of human resources, including improvement of human resources through advances in education. Productivity, both of labour and of other factors, rose less than in developed countries, as reflected in the persistent lack of technological progress in the region (see figure III.1).

The pace of industrialization increased in nearly all the countries of Latin America and the Caribbean during the first two decades following the Second World War, when a great number of factories sprang up, producing non-durable consumer goods. In the most developed and biggest Latin American countries, the industrialization process also included the establishment of metalworking industries producing consumer durables and capital goods.<sup>32</sup> These advances formed the basis for a substantial local technological capacity and, as the structure of production became

more complex and more integrated, an "industrial culture" slowly evolved. The comparative advantages of many of the countries of the region thus gradually changed to a pattern based on international specialization geared mainly towards agroindustrial activities and the metalworking complex.

Total factor productivity in the region developed along a path parallel to that followed in the United States; however, this translated into rates of technological progress considerably lower than those achieved during the same period by other OECD countries and the developing countries of Asia (see figure III.2).

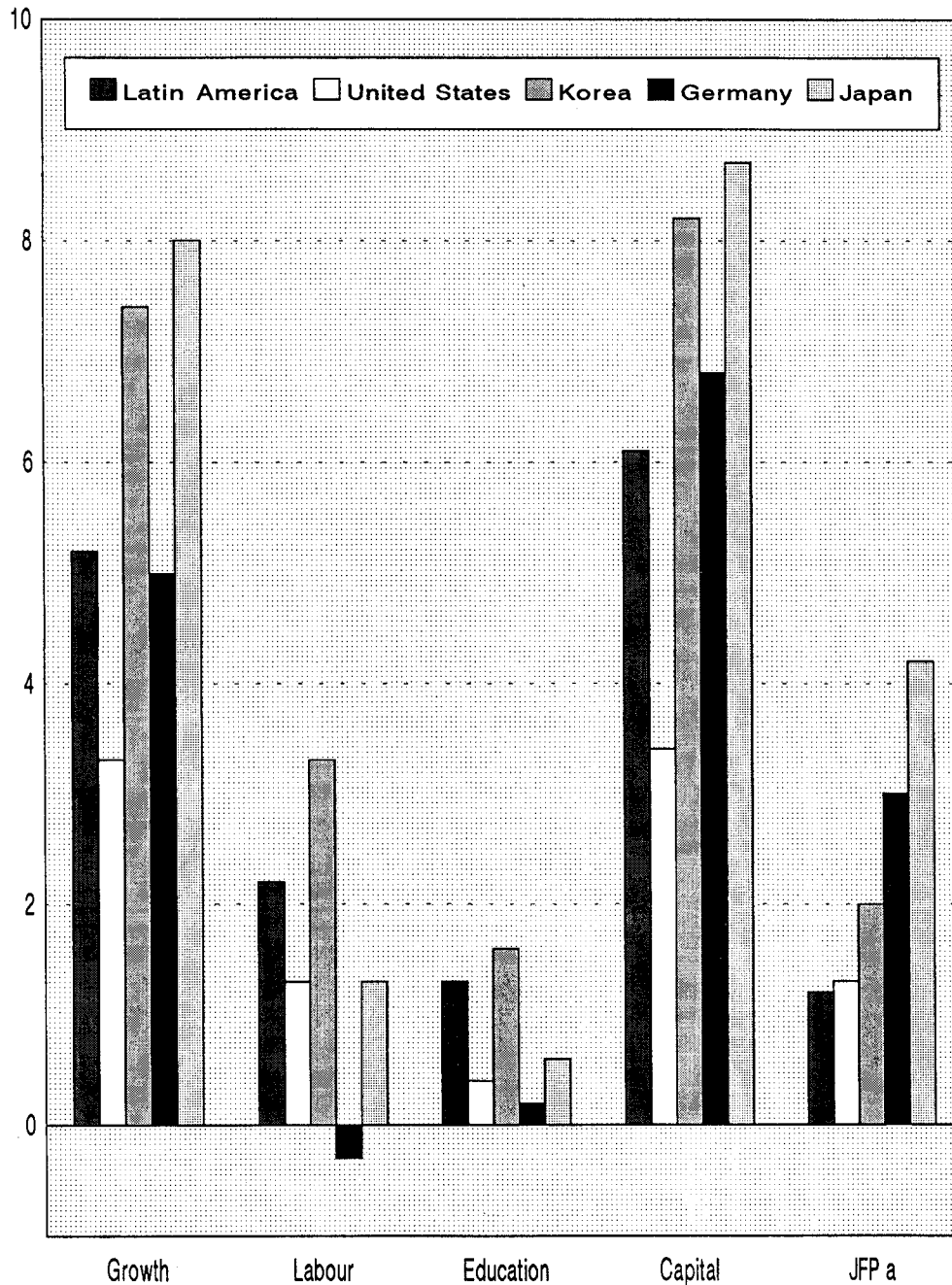
In spite of the inward orientation of industrialization, a gradual process of internationalization of the manufacturing sector began during this phase, at least in Brazil, Argentina and, later, Mexico. However, exports continued to consist chiefly of commodities and tended to expand less rapidly than output. Although manufacturing exports grew vigorously in some countries, the new and commodity-based industries still did not have a significant share in total exports.

Between 1973 and 1980, the level of economic activity in the region continued to rise, albeit at a somewhat slower rate and with greater disparities in

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<sup>32</sup> In particular, automobiles, agricultural equipment, tractors and heavy machinery for the chemical and petrochemical industries.

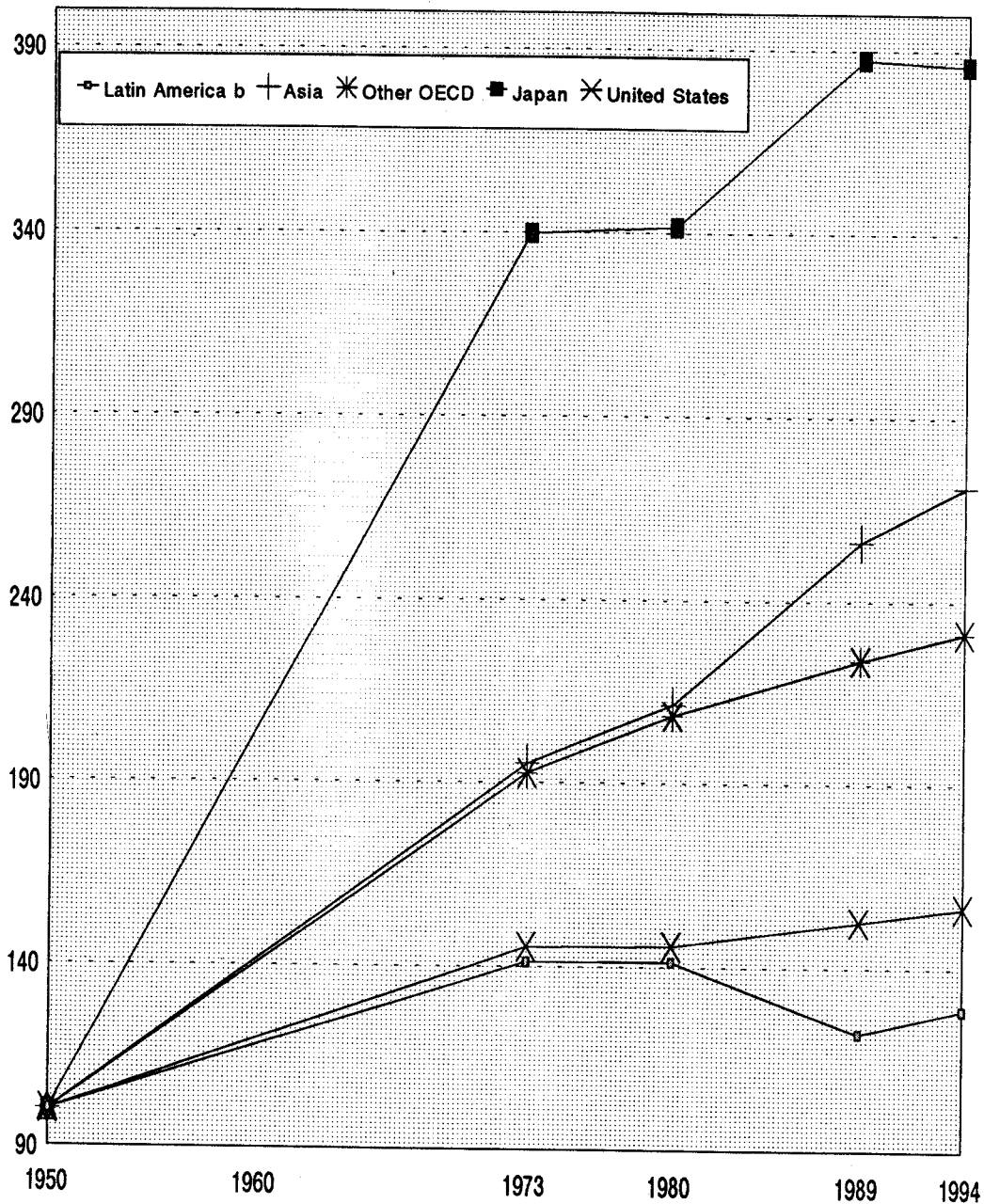
Figure III.1  
**ECONOMIC GROWTH AND ACCUMULATION OF THE FACTORS OF  
 PRODUCTION, 1950-1980**  
*(Average annual rates of variation)*



Source: ECLAC, on the basis of estimates by A. Hofman, "Economic growth and fluctuation in Latin America. The long run", document presented at the Conference on "Development strategy after neoliberal economic restructuring in Latin America", Miami, North-South Center/University of Miami, 1995.

a Joint factor productivity (JFP); in the case of labour increases in the average number of years of education are included.

Figure III.2  
**INTERNATIONAL COMPARISON: TOTAL FACTOR  
 PRODUCTIVITY<sup>a</sup>**  
 (Indexes 1950=100)



Source: ECLAC, on the basis of estimates by A. Hofman, "Economic growth and fluctuation in Latin America. The long run", document presented of the Conference on "Development strategy after neoliberal economic restructuring in Latin America", Miami, North-South Center/University of Miami, 1995 (updated by the author).  
 a In the case of labour, increases in the average number of years of education are included.  
 b Average for Argentina, Brazil, Chile, Colombia, Mexico and Venezuela.

performance between countries. For some –Paraguay, Brazil, Mexico and Ecuador– these were years of significant growth, while others, such as Argentina, Chile, Peru and Bolivia, lost momentum.

During this period, growth in the region's export volume was slight, although there was significant diversification into manufactures as a result of the gradual specialization in textile and metalworking products, which was then in its early stages. Import volumes, by contrast, increased appreciably, boosted by improved terms of trade and the growing availability of external finance.

The relatively rapid growth of regional output (nearly 5% per annum) and of gross fixed capital formation (6.5% per annum) occurred amid increasing macroeconomic turbulence caused by the decade's two oil crises and by the spectacular surge in international interest rates.

At the same time, the basis of the internal dynamism which had underpinned inward-oriented industrialization was beginning to weaken steadily. In many countries, internal absorption of resources tended to rise at rates far in excess of output growth, producing inflationary pressures and a gradual increase in external borrowing from 19% to 33% of regional output.

At different times and with more or less commitment, Governments set up macroeconomic stabilization programmes –and structural reform programmes in the Southern Cone countries– which led, among other things, to considerable changes in the systems of incentives and regulatory frameworks which prevailed in the region's economies, and to changes in the behaviour of economic agents and in the functioning of markets.

It is hardly surprising, against such a background, that growth in total factor productivity should have slowed from an annual rate of 2.3% between 1950 and 1973 to 1% between 1973 and 1980 (see figure III.2).

The 1980s were marked by virtual stagnation in the level of activity and major macroeconomic disequilibria. During this period the region suffered a sharp relative setback in the global economic context. Total factor productivity dropped by nearly 1% per annum between 1980 and 1989, in contrast with the rise of around 1.2% in the developed world and around 4% in the newly industrializing Asian countries.

In addition to the effects of economic stagnation and falling investment on productivity, the gap between the region and the international production efficiency frontier widened. Regional industrial labour productivity dropped from 33% to 27% compared with that of the United States.

Despite the diversity of macroeconomic scenarios displayed by the countries of Latin America and the Caribbean in the 1980s, the basic characteristics of structural change were similar. First, there was a restructuring towards services and activities which were not tradable abroad. Secondly, industries making relatively intensive use of natural resources developed, a trend already discernible towards the end of the previous decade. At the same time, the metalworking sector underwent a relative contraction.<sup>33</sup>

During the 1990s, the level of activity in the region has increased at a moderate, though steady, pace,<sup>34</sup> and the growth rates of the different countries have gradually converged. Investment has slowly recovered, albeit with great

33 This trend was very marked in countries such as Argentina and Chile, though not as much in Brazil, where it was decided to maintain the system of producing capital goods set up during the phase of import-substitution industrialization.

34 The average annual growth rate in the region between 1990 and 1994 was 3.6%. The fall to 0.6% in 1995 was almost exclusively due to the recessions in Argentina and Mexico, since the level of activity in the remainder of the countries of the region went up to somewhat over 4% (ECLAC, 1995a).

disparities between countries, substantial productive rationalization has taken place in economic units, and there has been moderate growth in total factor productivity (see figure III.1 and table III.1).

The level of internationalization of the structures of production and consumption has also increased appreciably during the 1990s. Unlike in the 1970s, when import volume grew, but export volume did not, and in the 1980s, when the reverse was true, during the first half of the 1990s trade in both directions has increased considerably, although imports have grown more.

#### **B. MICROECONOMIC BEHAVIOUR UNDER DIFFERENT MACROECONOMIC AND REGULATORY FRAMEWORKS**

In the 1970s, the region completed a relatively successful phase of industrial development. The technical know-how accumulated during the stage of rapid manufacturing expansion from 1950 to 1970 enabled a number of industrial sectors and many firms to narrow the gap between their productivity levels and the level possible with the most advanced technology available internationally. Despite the predominantly inward orientation of the import-substitution model of industrialization, the countries were gradually able to improve their international competitive position and to expand their export coefficients and international sales of products of greater technological complexity. In the 1970s, there was evident progress in this direction in Argentina, Brazil, Colombia and Mexico, all of which successfully

penetrated regional markets with capital goods of moderate technical sophistication, such as automobiles, tractors, agricultural and transportation equipment, heavy boiler equipment, ships and other products.

In Central America, medium- and large-scale industry in each country developed its own profile of specialization. Guatemala, for example, exported pharmaceutical products, tires, soaps and detergents, glass products, canned foods and paper. El Salvador specialized in fertilizers, electrical supplies, textiles, footwear and cardboard. Nicaragua's chief exports were vegetable oils, insecticides, caustic soda and synthetic resins. Honduras, which lagged behind the rest of the subregion in manufacturing, became a major supplier of basic grains.

The new specialization patterns of the Central American countries were heavily influenced by the subregional integration process, which helped to accelerate both overall and manufacturing growth.<sup>35</sup> During this same period, however, the Central American manufacturing sector developed characteristics that foreshadowed the problems that would lead to the exhaustion and ultimately to the alteration of the model. Generally speaking, the sector depended heavily on imports of capital goods and to a lesser extent of inputs from outside the region, while it failed to generate foreign exchange by exporting its products outside the region, thus becoming vulnerable to a potential balance-of-payments crisis (Buitelaar, 1995).

The programmes of adjustment, stabilization and structural reform implemented in the region during the 1980s drastically altered the system of macroeconomic incentives and the regulatory framework in which economic

<sup>35</sup> According to the Rosenthal Report (SIECA, 1973-1974), in the absence of the Central American Common Market, the output of the countries of the subregion would have expanded by 4.9% between 1962 and 1968, whereas thanks to integration the growth rate was 6.5%. In addition to generating this significant improvement, especially striking in Guatemala and Nicaragua, the integration process had a highly stimulating effect on industrialization at a relatively low cost; this was reflected in industrial GDP growth rates higher than those for the region as a whole, with the exception of Honduras, where the rate was equal to the regional average (Buitelaar, 1995).

Table III.1  
**LATIN AMERICA (SIX COUNTRIES): INTERNATIONAL COMPARISON  
 OF GROWTH AND TOTAL FACTOR PRODUCTIVITY, 1950-1994**  
*(Average annual rates of variation)*

	Gross domestic product <sup>a</sup>		Labour <sup>b</sup>		Capital		Total factor productivity <sup>b</sup>	
	1950-1980	1989-1994	1950-1980	1989-1994	1950-1980	1989-1994	1950-1980	1989-1994
Latin America	5.3	4.0	3.6	3.7	6.2	2.3	1.2	1.1
Argentina	3.8	6.1	2.1	2.3	4.9	0.8	1.0	4.5
Brazil	7.0	0.9	4.4	2.8	9.8	2.3	1.2	-1.6
Chile	3.4	6.4	1.8	4.1	4.0	4.7	1.1	2.5
Colombia	5.1	4.3	3.6	4.0	4.1	3.5	1.7	0.8
Mexico	6.5	3.0	4.4	3.7	7.7	2.4	1.5	0.1
Venezuela	5.9	3.6	5.2	5.5	6.6	0.2	0.7	0.3
Asian countries	7.7	7.6	5.0	1.5	6.7	7.4	2.6	4.4
Japan	8.0	3.8	1.8	1.7	8.7	10.5	4.3	-0.4
Other OECD countries	4.1	1.7	0.1	0.5	5.5	3.0	2.4	0.5
United States	3.3	1.7	1.7	0.9	3.3	2.2	1.3	0.5

Source: ECLAC, on the basis of estimates by A. Hofman, "Economic growth and fluctuation in Latin America. The long run", document presented at the Conference on "Development strategy after neoliberal economic restructuring in Latin America", Miami, North-South Center, University of Miami, 1995; and "Capital stock in Latin America: a 1994 update", *Cambridge Journal of Economics*, forthcoming.

<sup>a</sup> In dollars at 1980 prices.

<sup>b</sup> The figures for labour include increases in the average number of years of education.

agents operated, triggering a series of changes in the way firms behaved and the way markets and institutions functioned.

Not all firms, industries and regions of a given country possessed the same capacity, information or access to resources needed to adapt to the new frameworks and "ground rules". Consequently, in all the economies, macroeconomic stabilization programmes and structural reform acted as powerful forces of selection that deeply altered the structure and behaviour of the productive system.

In each country there emerged a group of firms –small in number but important in generating domestic output– that responded "proactively"; that is, they dynamically assimilated the new conditions of their environment, made major changes in their operating procedures and expanded their investment and physical production capacity by building new manufacturing plants and applying new work organization methods. A second group of firms reacted "defensively"; that is, they

managed to adapt to the new conditions by making minor changes –reorganizing, subcontracting, outsourcing and dismantling vertical integration structures– but without making major investments or significantly expanding installed capacity. Lastly, a third group of firms, probably the largest numerically, but accounting for a smaller proportion of output, lacked the capacity, information or resources to adapt; some of these firms have disappeared and others have fallen far behind the first two groups.

The new model of development forced the subsidiaries of transnational manufacturing companies to choose between three broad options: i) to withdraw and hence to disinvest; ii) to adopt a defensive strategy, involving streamlining based on new information and management technologies, cost-reduction, job-cutting and suspension of any significant new investment; and iii) an offensive strategy involving restructuring, new investment and increased competitiveness and entailing the

redefinition of the role of the subsidiary in the local market within the framework of the parent company's new global strategy. Initially, a great many of these firms opted for defensive streamlining strategies (Mortimore, 1995).

The macroeconomic imbalances of the 1980s created conditions and signals that encouraged economic agents to pay more attention to finance and speculation than to technology and engineering. Conditions encouraged short-term decision-making and worked against investments with a longer pay-back period and against markets and contracts difficult to assess because of their risk and uncertainty factors. The planning horizon of firms shrank to very short time periods, and as a result investment in modern technologies and equipment related to new product design declined, and fewer funds were allocated to maintaining engineering and research and development departments.

Moreover, the decline in levels of economic activity and investment, to begin with, and the subsequent liberalization of trade meant that the change in the ground rules had a more adverse impact on the industries engaged at that time in producing consumer durables and capital goods for the domestic market than on the exporting sectors. The result was that processors of raw materials or producers of widely-used primary industrial commodities were the chief beneficiaries of the new macroeconomic incentives.

Despite the great diversity across the region of methods of macroeconomic management and regulation, it is evident that the process of restructuring production generally tended to work in favour of natural-resource-intensive products and against more engineering- and technology-intensive products. The net result has been a proportional decline in metalworking and capital-goods-producing activities, both requiring a high level of technology and engineering services and both industries that had been comparatively more dynamic during the

import-substitution phase of industrialization. It is also generally observable that the proportion of non-tradable activities and services in the productive system has increased, while manufacturing has fallen behind.

### C. CHIEF CHARACTERISTICS OF THE RESTRUCTURING OF PRODUCTION

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#### 1. The productive interplay of goods and services

As ECLAC has repeatedly emphasized, it is important not to reduce the analysis of trends in production to merely sectoral perspectives. The new competitiveness is bound up with the characteristics of the emerging technological pattern, which in turn is driven by two interdependent forces: i) the dissemination of microelectronics-based information technologies; and ii) the spread of a new managerial and administrative model. These two powerful forces intersect with the cycle of production and trading to redefine both end-product technologies and technologies used in the processes of production and organization.

The application of information technologies to company management—in administration and production—presents special features which illustrate the interplay of services and industry. If such services are provided by the enterprise itself, they are reckoned as industrial value added; however, if the same services are contracted on the open market, they represent service sector transactions. Thus, the current trend towards subcontracting or outsourcing of services increases the number of transactions recorded between the service sector and other sectors of the productive system and strengthens the markets in which these transactions take place. This gives rise to services which operate on an industrial scale. The idea that industry's relative importance may be declining is therefore one that needs to be approached with

caution and interpreted in the light of these trends in the restructuring of production.

Recent privatizations in energy and telecommunications have helped trigger a major productive investment process which has galvanized those sectors and also given impetus to the construction and transport sectors. At the same time, the mobilization of financial resources, in some cases from pension funds or bond and stock issues on the local market, has fostered a deepening of the capital market. Such experiences demonstrate the possibilities for expanding production capacity through links with a growing number of increasingly complex types of financial service.

Moreover, greater output in agriculture, mining and manufacturing commodities has led to significant expansion of some service sectors. Production of raw materials and commodities for export demands an extensive transport, port and communications infrastructure, which helps to explain only the average growth rate in the transport, storage and communications sectors has doubled that of GDP since 1980. A similar phenomenon has occurred in the electricity, gas and water sector, which has been one of the most vigorous sectors over this same period, reflecting both the energy needs of the new, natural resource-based production activities and the discovery of new sources of non-renewable energy.

The lowering of trade barriers and the dynamics of progress in technology and in organizational methods have also rendered the demarcation between tradables and non-tradables fluid and imprecise. The export of financial, engineering and

consulting services has turned many services which until recently were non-tradables into tradables.

Because the limitations of the available data do not permit a more integrated analysis, an overview of trends in each sector will now be presented, with these considerations in mind.<sup>36</sup>

## 2. Changes in sectoral structure

In the 1970s, non-tradables sectors grew more vigorously than tradables, and, among tradables, the lag in agriculture and, particularly, mining, was greater than in manufacturing. In some countries, labour productivity in the service sector rose faster than in the economy as a whole.

In the 1980s it was manufacturing that lagged behind, with falling productivity and levels of activity that hovered around a bare minimum of growth, while agriculture and mining achieved growth above that of regional output as a whole (see table III.2a).

The recovery experienced during the 1990s has been spread, generally speaking, over all sectors.<sup>37</sup> Even so, among tradables, mining stands out, while non-tradables such as energy, construction and transport have turned in performances far superior to that of the economy as a whole.<sup>38</sup>

Changes in the sectoral composition of regional output over two decades have been slight (see table III.2b), although it must be acknowledged that the aggregated picture does not fully represent the degree of intrasectoral change. Nevertheless, a comparison of the sectoral breakdown at the beginning and

<sup>36</sup> The ECLAC programme of work provides for the preparation of methodologies and diagnostic procedures more relevant to the study of the current restructuring of production; based on the analysis of investment processes and the linkages being created between various sectors of production.

<sup>37</sup> The most notable exception has been social and community services, where activity has dropped considerably owing to the cutbacks in current fiscal spending and public sector rationalization.

<sup>38</sup> The processes of trade liberalization, market deregulation, privatization and opening up to foreign investment have brought about institutional changes which make it necessary to update conventional analytical categories such as tradable and non-tradable goods and services, and goods-producing and service-providing activities.

Table III.2a  
**LATIN AMERICA AND THE CARIBBEAN: TRENDS IN GDP BY SECTOR**

(Average annual rates of variation)

	1973- 1980	1980- 1990	1990- 1994
Total GDP	5.5	1.6	2.9
Agriculture	3.5	2.3	2.2
Mining	1.5	2.3	3.8
Manufacturing	5.1	0.8	2.2
Energy	9.0	5.4	4.3
Construction	6.3	-1.7	3.6
Commerce	6.1	0.9	3.0
Transport	8.3	3.8	5.4
Financial services	6.6	2.7	2.5
Social services	6.1	2.6	1.5
Total service sector	6.2	2.0	2.3

Source: ECLAC, on the basis of official figures.

Table III.2b  
**LATIN AMERICA AND THE CARIBBEAN: BREAKDOWN  
 OF GDP BY SECTOR**

	1973	1980	1990	1994
Total GDP	100.0	100.0	100.0	100.0
Agriculture	10.6	9.1	9.9	9.9
Mining	6.1	4.1	4.7	4.8
Manufacturing	26.6	26.0	23.7	23.3
Energy	1.1	1.4	2.1	2.2
Construction	6.6	7.0	4.8	5.3
Commerce	16.9	17.7	15.9	16.2
Transport	4.5	5.4	6.5	7.4
Financial services	11.6	12.6	14.3	13.6
Social services	15.8	16.6	18.1	17.0

Source: ECLAC, on the basis of official figures.

end of the period 1973-1994 reveals some significant changes:

i) The share of the transport and financial services sectors combined has grown continuously, expanding from 16% of GDP in 1973 to 21% in 1994. As the bulk of this growth occurred between 1980 and 1994, when GDP was expanding at more moderate rates, it could be a reflection of trade liberalization, domestic financial

reforms and the liberalization of the capital account. The share accounted for by agriculture and mining has remained relatively constant, though during the 1990s mining has grown faster than output as a whole.

ii) The share of tradables (mining, agriculture and manufacturing) in total GDP fell significantly between 1973 and 1994, from 44% to 38%. The energy sector,

by contrast, performed very well, maintaining high growth rates even during the 1980s.

iii) Among the tradables, the share of agriculture and mining declined during the 1970s, while manufacturing's remained relatively steady; but from 1980 onwards agriculture and mining have recovered, while manufacturing share has fallen.

These trends are a result of changes in the vitality of the main sectors, which may be summarized as follows:

In the 1970s, agriculture in the region expanded less than total output. However, this sector was particularly strong in Paraguay (6.7% annual growth), Guatemala and Brazil (4.7%) and Colombia (4.4%), where it amply exceeded the regional annual average of 3.5%.

In the 1980s, the rate of growth in agriculture dropped from the level of the 1970s. However, it dropped considerably less than that of the economy as a whole, particularly during the first half of the decade, so that agriculture regained some of its relative importance. Brazil turned in the best agricultural performance (3.8%) in the first half of the 1980s, and Chile in the second half (7.8%).<sup>39</sup> To date in the 1990s, it is the Central American agricultural sector that has been most vigorous and most stable. In 1991-1993, the results in agriculture in Costa Rica, Honduras, Panama and the Dominican Republic were above the regional average. In the Caribbean, after sharp drops in production at the end of the 1980s, the sector made a remarkable recovery in Guyana (14.2% per annum between 1991 and 1993) and Jamaica (7.2%).

Mining's share of GDP fell significantly, from 7.0% to 4.1%, between 1970 and 1980, owing to the low rate of growth in output (1.5% per annum). During the 1990s, however, the sector has recovered, as a result of changes both in the international scenario and in national

policies on the treatment of foreign investment. Not counting oil, the best mining performances in the 1980s were recorded in Ecuador (31% annual growth), followed by Colombia (8.3%) and Brazil (5.6%). These rates compare favourably with the regional average for the sector, which was a mere 3.4% per annum. From 1990 to 1993 the annual average fell to 1.7%, although mention should be made of Guyana (14.7% annual growth – though this performance was highly unstable and fell by 56% in 1992), Chile (6.4% with greater stability) and Brazil (7.9%).

Manufacturing industry's share of output (almost 26%) held during the 1970s because growth in the sector was more than proportionate to GDP in those countries with more vigorous economies (Brazil, Ecuador, Mexico) and setbacks were less marked in stagnant economies (Argentina, Chile). The sector's share fell significantly during the 1980s and to date in the 1990s has hovered around 23%. In the last few years, as in the 1970s, manufacturing has achieved more than proportional growth in those countries where levels of economic activity have risen more quickly (Argentina, Chile, Costa Rica). From 1990 to 1993, the best performances, in terms of cumulative growth, were recorded in Guyana (10.1% between 1990 and 1992), Argentina (6.5%) and Chile (5%).

### 3. The new role of natural resources

The end of the process of industrialization based on import substitution and the spread of the external debt crisis at the beginning of the 1980s marked the start of a transition period in which natural resource-intensive production of tradables (in agriculture, mining and manufacturing) proved more resistant to the crisis and also more adaptable to the new development scenario.

<sup>39</sup> This is attributable to the higher degree of protection afforded the sector after the policy of price bands for key agricultural products was reintroduced and the real exchange rate rose sharply, in the second half of the 1980s.

This is the main conclusion to be drawn from a comparison of agricultural, mining and natural resource-intensive sectors of manufacturing (food, beverages and tobacco, paper and pulp, basic chemicals and petrochemicals, iron and steel and basic metallurgy), with the remaining, non-natural resource-intensive tradables-producing activities (see table III.3).

Natural resource-intensive tradables production declined significantly during the 1970s, both as a proportion of tradables as a whole and in relation to total output, owing particularly to the contraction in mining. During the 1980s, there was an especially marked decline in the case of manufactures with a low input of natural resources, while natural resource-intensive tradables recovered as a proportion of tradables as a whole (from 62% to 67%) and as a proportion of regional GDP (from 24% to 26%). During the 1990s, these percentages have remained relatively stable.

The greater resistance of natural resource-based activities to the vicissitudes of crisis can be attributed to several factors. To begin with, natural resources themselves offer inherent comparative advantages. Secondly, the high exchange rates that prevailed for most of the 1980s favoured exports. The competitiveness of mining and agroindustry also increased as a result of new investment in advanced technology at the international level.

Over the last two decades, Latin American and Caribbean agriculture has steadily expanded owing to increases in labour and land productivity. The slowdown in the sector recorded during the 1980s was not so much a result of structural constraints on supply as of a drop in domestic demand and also, to some extent, to lower profitability due to the marked decline in international prices.

In the last 20 years, production of most major minerals in the region has grown faster than economic activity in general. Metal refining has also grown more than mining production itself. These trends

have solid bases in an international context. First, the ore grade of deposits in the region is superior to the global average. Secondly, production is tending to contract in the major developed countries, where deposits are being exhausted and costs associated with energy and environmental protection are high. Thirdly, the developed countries are tending to import mineral products that incorporate greater value added. Lastly, the mining industry worldwide is tending to become concentrated in the hands of large transnational corporations, which counteract the downward trend in mineral prices with technological innovation at all stages of production.

On this basis, the share of Latin America and the Caribbean in world trade in major metals has increased significantly, as has the processing level of its mineral exports. Investment in the region by international mining companies seeking to exploit these changes in the global climate has been made easier by deregulation, policies favouring foreign investment, and reform of mining legislation. The fact that over one third of investment planned for the remainder of the decade worldwide is destined for mining in this region suggests a promising future (see table III.15 in section E. 4).

Latin American and Caribbean industry has, as mentioned above, moved away from the old model of specialization, based in the most advanced countries on the primacy of the metalworking sector and in nearly all the rest on semi-skilled labour-intensive industries, towards a new model which relies on the impetus of natural resource-intensive activities.

In the latter part of the 1970s and during the 1980s, the basic industrial commodities sector (petrochemicals, aluminium, pulp and paper, iron and steel, non-ferrous metals), which had been stimulated by the development policy that prevailed during the last phase of import-substitution industrialization, introduced more capital-intensive plants which were closer to the international technology frontier and which did not

Table III.3  
**LATIN AMERICA AND THE CARIBBEAN: BREAKDOWN OF GROSS  
 DOMESTIC PRODUCT, BY PRODUCTIVE ACTIVITY**  
**(TRADABLES AND NON-TRADABLES)**  
*(Percentages of GDP)*

	1970	1980	1990	1993
1. Agriculture	11.2	9.1	9.9	9.6
2. Mining	7.0	4.1	4.7	4.7
3. Manufacturing	26.2	26.0	23.7	23.5
3.1 Natural resource- intensive	11.4	11.2	11.1	10.8
3.2 Non-natural resource- intensive	14.8	14.8	12.6	12.7
4. Other	55.6	60.8	61.7	62.2
Total GDP	100.0	100.0	100.0	100.0
5. Tradables as a percentage- of GDP (1+2+3)	44.4	39.2	38.3	37.8
6. Natural resource- intensive tradables as a percentage of GDP (1+2+3.1)	29.6	24.4	25.7	25.1

Source: ECLAC, on the basis of official figures.

require large workforces. At the same time, agroindustries with similar features developed.

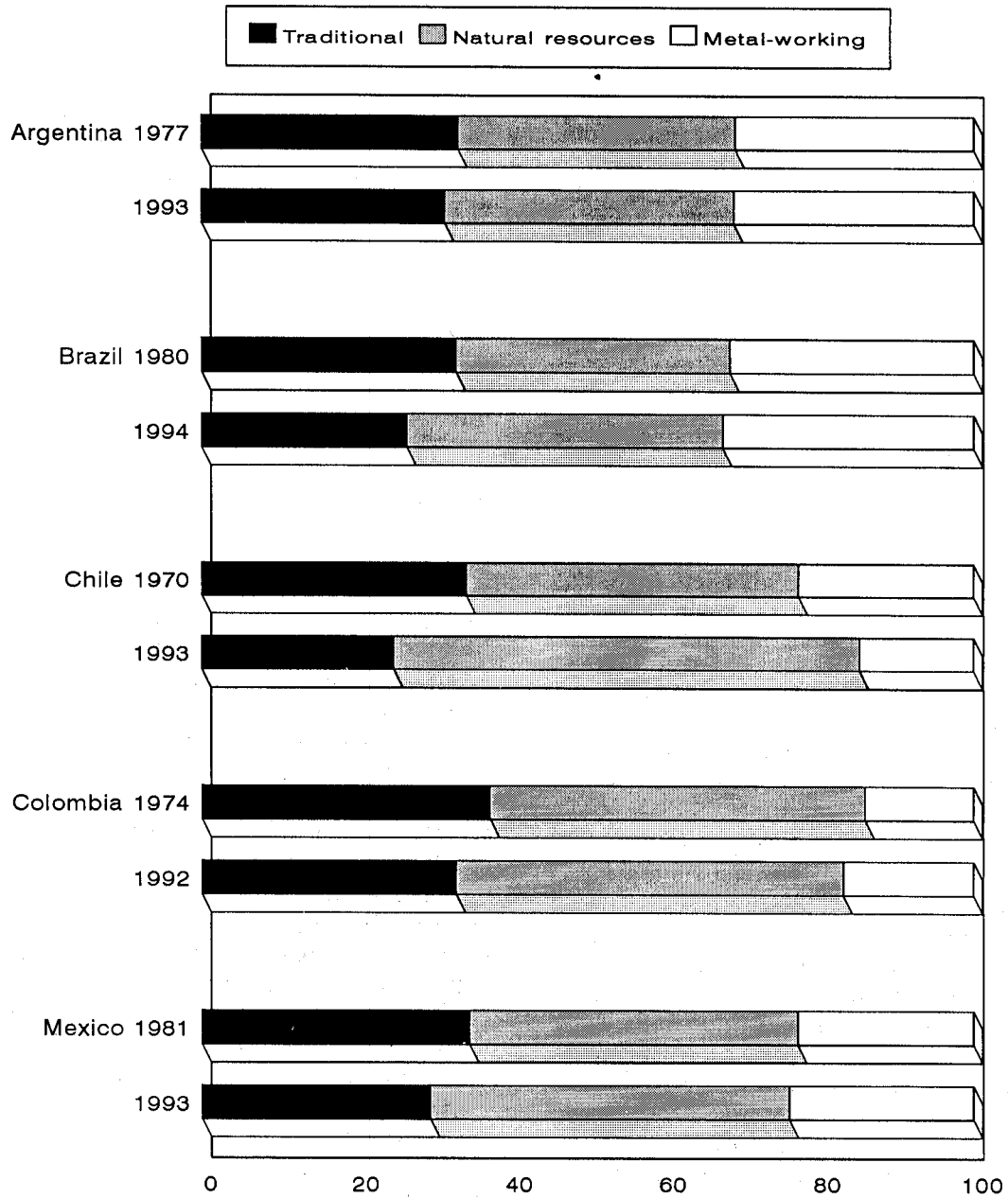
Between the 1970s and the early 1990s, natural resource-based manufacturing as a whole (including the traditional food and beverage industries) came to represent almost two thirds of manufactured value added in the most industrialized countries of the region (see figure III.3).

This development can be attributed to three factors. First, the abundance of natural resources in the countries of the region offers comparative advantages. Secondly, from the 1980s onwards, the productivity of natural resource-based sectors has been greater than that of non-natural resource-intensive manufacturing. Thirdly, natural resources have become more readily available thanks to the implementation of public policies of subsidies and support for research and development in previous decades.

In natural resource-based sectors of manufacturing, the greatest increases in productivity have been in modern plants of a size consistent with international minimum scale requirements. In agriculture, despite its great diversity, application of a capitalist model of land utilization has intensified, and increasing technical progress in agriculture, forestry and fishing has made possible fresh advances towards the economic frontier of available natural resources.

To summarize, the growing tendency to incorporate technical progress has become more closely allied to exploitation of natural resources, particularly in the case of mining, but also in other primary activities. In addition, there has been intensive incorporation of technology throughout the agricultural distribution process, including packaging, refrigeration facilities along the distribution chain, and shipping.

Figure III.3  
**LATIN AMERICA AND THE CARIBBEAN (5 COUNTRIES): STRUCTURE OF THE MANUFACTURING INDUSTRY**  
*(Percentage breakdown of value added by sector)*



Source: ECLAC, on the basis of official figures.

#### 4. Restructuring and international integration of industry

The restructuring of the industrial sector is producing a shift from a pattern of specialization based on the metalworking complex<sup>40</sup> to one of gradually increasingly emphasis on branches of industry with a high natural resource input. While these are not entirely new branches (aluminium, petrochemicals, pulp and paper, iron and steel, non-ferrous metals, foods), in the second half of the 1970s and the decade of the 1980s they received a new infusion of capital and were equipped with a new generation of highly modern production plants and up-to-date technology. The new plants operate on a continuous-flow basis and their operation is governed by process technology (machine-paced); in contrast to the metalworking industry, they rely less on labour, industrial engineering and production methods.

Along with the shrinking importance of the metalworking industry, there has also been a decline in textiles, leather goods and footwear. Other high-value-added and industrial-engineering-intensive production activities, such as the capital goods and pharmaceutical industries, have also lost ground.

This "destruction of production capacity", however, need not be considered an irreversible trend. It is quite possible that once stabilization is consolidated and rates of saving and investment rebound, a new phase of creation of production capacity will ensue. Chile, whose economy is furthest along the road of reform, went through a period in the early 1980s when over 6,000 manufacturing firms closed down, but a decade later it was apparent that dynamic processes of learning-by-doing, technological modernization and export openness in new industrial sectors were under way. Something similar

appears to be happening in small and medium-sized firms in Argentina and Brazil.

Although the relative decline of traditional industry and the advance of foods and beverages have been widespread phenomena, the trend varies somewhat from country to country. Table III.4 shows that over the course of two decades, the most radical changes in productive structure took place in Chile, where the traditional metalworking industry declined in relative importance in relation to food and beverages and basic industrial commodities. In Brazil, on the other hand, metalworking maintained its relative position, and in Colombia even gained slightly.

In the countries in question, the increased availability and quality of raw materials has brought about a rapid expansion of the industries that process them. Generally speaking, these new industrial facilities handle only the initial processing steps, without contributing much domestic value added or undertaking the fabrication of specialty products (finished papers, hydrogenated or low-cholesterol food oils, specialty steels, aluminium shapes, instant coffee or copper alloys, to name a few), a job that tends to be left to the foreign purchasers.

None the less, there has been a strong expansion in exports of widely-used basic commodities, including foods (see table III.5).

Trends in industrial trade coefficients vary from country to country. Tables III.5 and III.6 show that in Chile, Colombia and Mexico both export and import coefficients increased; in Argentina only the import coefficient increased; while in Brazil the chief increase was in the export coefficient.

As the garment industries failed in the Caribbean under the prevailing regime, government sought to resuscitate and expand them, with some success, within the ambit of export processing zones

<sup>40</sup> The metalworking complex refers to a category of industries chiefly concerned with the technical subprocesses of producing and assembling metal parts and components; all these tasks are labour-intensive and require skilled human resources, industrial engineering, work planning and production methods. These are the industries that produce, for example, consumer durables, automobiles, relatively simple capital goods such as motors and boilers, agricultural equipment and food processing equipment.

Table III.4  
BREAKDOWN OF VALUE ADDED IN MANUFACTURING

	Chile			Argentina			Mexico			Brazil			Colombia		
	1970	1990	1993	1977	1990	1993	1981	1990	1993	1980	1990	1994	1974	1990	1992
Total manufacturing	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100
General metal manufactures and machines	14.9	10.2	12.0	19.8	14.3	17.6	14.5	12.3	12.6	23.7	22.9	23.8	9.6	9.6	10.3
Motor vehicles	7.7	2.3	2.6	10.8	8.5	13.5	8.3	9.5	11.1	7.8	7.0	8.7	4.5	4.3	6.5
Total metal-working industry	22.6	12.5	14.7	30.6	22.8	31.0	22.7	21.8	23.8	31.5	29.9	32.4	14.0	13.9	16.8
Food, beverages and other	25.2	33.8	36.0	20.6	24.3	21.0	24.4	25.8	26.8	14.4	15.2	15.4	29.2	31.1	30.0
Basic industrial commodities <sup>a</sup>	18.0	21.5	24.5	15.5	22.4	16.6	18.3	21.0	19.9	21.2	24.4	25.7	19.5	20.0	20.3
Subtotal	43.2	55.3	60.5	36.1	46.7	37.6	42.7	46.8	46.7	35.6	39.7	41.1	48.7	51.2	50.3
Traditional industries	34.2	32.2	24.8	33.1	30.5	31.4	34.6	31.4	29.5	32.9	30.5	26.5	37.3	34.9	32.9

Source: ECLAC, on the basis of official figures.

<sup>a</sup> Natural resource processing industries (pulp and paper, petrochemicals, iron and steel, aluminium, mining and other).

where they were subject to neither domestic nor regional regulations.

In Central America, the manufacturing sector has been lagging behind, and its growth rate in the 1990s has been lower than the average for the economy, a tendency that is reflected in the declining contribution of manufacturing to total GDP. This trend has been especially pronounced in Guatemala, Honduras and Nicaragua. In El Salvador and Costa Rica, on the other hand, manufactures have considerably increased their share of GDP.

Apart from this process of relative deindustrialization, the structure of manufacturing production in value terms did not undergo significant changes between 1990 and 1994. The food,

beverage and tobacco branch continues to be the most significant. With regard to the sector's size make-up, the great majority of Central American manufacturing firms are in the small-to-medium-sized category.<sup>41</sup>

One of the chief structural changes in the economies of Central America since the end of the 1980s has been the boom in non-traditional exports, particularly in-bond assembly (*maquila*) products. It is estimated that the *maquiladora* industry employed over 150,000 people in 1992. This has been a highly significant process; by 1994, *maquila* exports accounted for 48% of Central America's sales to the United States. In El Salvador, for example, they have become the leading export category, accounting for nearly 37% of

<sup>41</sup> In Guatemala, for example, small and medium-sized firms constitute 66% and 26%, respectively, of the manufacturing sector.

Table III.5  
EXPORT COEFFICIENTS

	Chile		Argentina		Mexico		Brazil		Colombia	
	1970	1992	1977	1992	1981	1992	1980	1992	1974	1992
Total manufacturing	4.42	18.30	8.45	9.37	2.50	10.12	8.81	17.20	8.31	13.75
General metal manufactures and machines	2.19	5.54	4.31	5.32	3.58	18.45	7.61	13.57	7.41	10.84
Motor vehicles	3.55	18.11	5.27	4.31	2.99	30.52	9.93	27.66	1.63	2.29
Total metal-working industry	2.69	8.18	4.65	4.83	3.32	24.63	8.32	17.48	5.42	7.61
Food, beverages and other	3.89	20.36	18.35	17.36	0.81	1.51	17.87	19.25	5.61	5.06
Basic industrial commodities <sup>a</sup>	11.71	27.84	4.31	10.03	5.42	11.95	5.32	21.21	6.52	12.02
Subtotal	6.88	23.16	13.39	14.65	2.62	5.56	10.6	20.45	5.96	7.91
Traditional industries	1.77	12.45	5.35	4.81	1.55	5.58	5.89	10.63	14.24	31.18

Source: ECLAC, on the basis of official figures.

<sup>a</sup> Natural resource processing industries (pulp and paper, petrochemicals, iron and steel, aluminium, mining and other).

Table III.6  
IMPORT COEFFICIENTS

	Chile		Argentina		Mexico		Brazil		Colombia	
	1970	1992	1977	1992	1981	1992	1980	1992	1974	1992
Total manufacturing	30.3	45.16	7.97	17.20	16.74	30.03	7.50	9.80	21.60	26.85
General metal manufactures and machines	84.58	141.15	15.99	48.81	56.31	102.16	14.00	18.02	60.49	96.19
Motor vehicles	67.75	242.64	10.19	22.81	29.42	54.27	7.98	12.04	53.84	69.88
Total metal-working industry	78.41	162.43	13.94	36.35	44.38	78.35	12.16	16.36	58.20	88.36
Food, beverages and other	8.99	5.51	0.51	2.75	2.97	7.18	1.86	4.91	3.47	3.48
Basic industrial commodities <sup>a</sup>	35.47	47.03	20.25	25.27	22.17	26.77	12.30	10.87	48.08	45.24
Subtotal	19.11	21.09	7.92	11.07	10.52	15.59	7.91	8.56	20.27	20.55
Traditional industries	8.84	25.76	1.57	7.55	4.27	13.72	1.12	4.26	5.13	7.19

Source: ECLAC, on the basis of official figures.

<sup>a</sup> Natural resource processing industries (pulp and paper, petrochemicals, iron and steel, aluminium, mining and other).

total exports. Notwithstanding the increase in non-traditional exports, much of the manufacturing output of each country goes either to the domestic market or to other Central American markets (Buitelaar, 1995).

#### D. PRODUCTIVE RESTRUCTURING AND INSTITUTIONAL CHANGES

Economic reforms and the transformation of the development mode are bringing about significant changes in economic structure (i.e., in the interplay of enterprises, productive agents, markets, sectoral policies and regulatory agencies).

Trade liberalization makes it imperative that the requirements of global markets be incorporated into production decisions and market strategies; privatizations and the deregulation of domestic markets create a new scenario in which private agents and public policies interact and institutions face new challenges with respect to the regulation and promotion of competition.

These transformations call for up-to-date analysis tools to achieve an in-depth understanding of the actual state of the productive process. A number of trends, particularly those relating to privatization, to revision of the regulations and incentives that apply to foreign investment, and to the restructuring of the energy sector, have brought about structural changes in several markets that are of critical importance to competitiveness, as well as changes in the roles of institutional actors.

##### 1. Privatization processes

Since the mid-1980s, the transfer of major public enterprises to the private sector has been part of structural reforms designed to transform the role of the State and increase the share of private investment in the economy.

The privatization process has encompassed very diverse sectors. It began with a disparate group of enterprises

involved in competitive markets, and later included manufacturing, financial services, transport companies and others connected with natural resources. More recently, privatization has extended to public utilities and infrastructure-related activities (see tables III.7 and III.8).

Privatization in Latin America has been experienced in various ways in terms of sequence, pace, intensity, sectoral coverage and transfer mechanisms. The process has been widespread in the case of enterprises in competitive markets and relatively large enterprises in the transport sector and agriculture-based industry. Privatizations scheduled for the next few years show a clear trend towards public utilities and infrastructure-related activities. Thus, for example, table III.7 shows the approach that countries plan to take, i.e., whether they plan to undertake privatizations or to enter into partnership with private agents, through concessions or similar arrangements, in the fields of energy (Bolivia, Brazil, Colombia, Costa Rica, Ecuador, El Salvador, Mexico, Panama, Paraguay and Venezuela); telecommunications (Bolivia, Brazil, Costa Rica, Ecuador, El Salvador, Guatemala, Honduras and Panama); port or road infrastructure (Brazil, Chile, Colombia, Ecuador, El Salvador, Guatemala, Mexico, Panama, Peru and Venezuela); and drinking water supply (Brazil, Ecuador, El Salvador, Honduras, Mexico, Panama, Paraguay and Venezuela). The participation of the financial services, transport and natural resources sectors in this process is less pronounced.

Among the most noteworthy events in this regard during 1995 were the partial implementation of the capitalization process in Bolivia, which will make it possible to channel investments equivalent to nearly 30% of GDP during the next seven years; Brazil's adoption of constitutional reforms that end State monopolies in the fields of telecommunications, natural gas distribution, hydrocarbons and shipping services; and the constitutional amendments introduced in Mexico to allow the participation of both domestic and foreign private investors

Table III.7  
**LATIN AMERICA AND THE CARIBBEAN (17 COUNTRIES): SECTORAL BREAKDOWN OF  
 PRIVATIZATIONS AND CONCESSIONS**

	Firms in com- petitive markets	Finan- cial serv- ices	Trans- port	Public utilities			Infrastructure		Natural resources		
				Tele- commu- nications	Elec- tric- ity	Water	Ports	Roads	Petro- leum, gas, petro- chemicals	Agro- indus- try	Min- ing
Argentina	X	X <sup>a</sup>	X	X	X	X	X	X	X	X	X
Bolivia	X		P	P	P				P	X	P
Brazil	X	P	X	P	P			P	X	X	X
Chile	X	X	X	X	X	P	P	X	X		X
Colombia	X	X	P		P	X <sup>a</sup>	P	X	P	X	X
Costa Rica	X	P		P	P				P	X	
Ecuador	X		P	P	P	P	P	X	P	X	
El Salvador	X	X	P	P	P	P	P			X	
Guatemala			X	P	X		X	P			
Honduras	X		X	P	X	P		X		X	
Mexico	X	X	X	X	P	P	P	X	P	X	X
Nicaragua	X			P					P	X	X
Panama	X		X	P	P	P	X	P		X	
Paraguay	P		X		P					P	
Peru	X	X	X	X	X	P	X	P	X	X	X
Uruguay		X	X				X	P	X		
Venezuela	X	X	X	X	P	P	P	P	X	X	P

Source: ECLAC, on the basis of official figures and *Privatisation International*, various issues.

<sup>a</sup> Limited privatization only, although an intensification of the process in the sector has been announced.

X = Privatization already carried out, though the extent of the process varies from one country to another.

P = Privatization envisaged.

in the fields of transport, telecommunications, natural gas and infrastructure.

In the case of Argentina, the financial restructuring of the provincial governments is providing new momentum for the privatization of public enterprises, this time on the regional level. In Chile, the increasing use of concession mechanisms is providing more openings for private investment in infrastructure, natural gas distribution and sanitation, including sewage treatment.

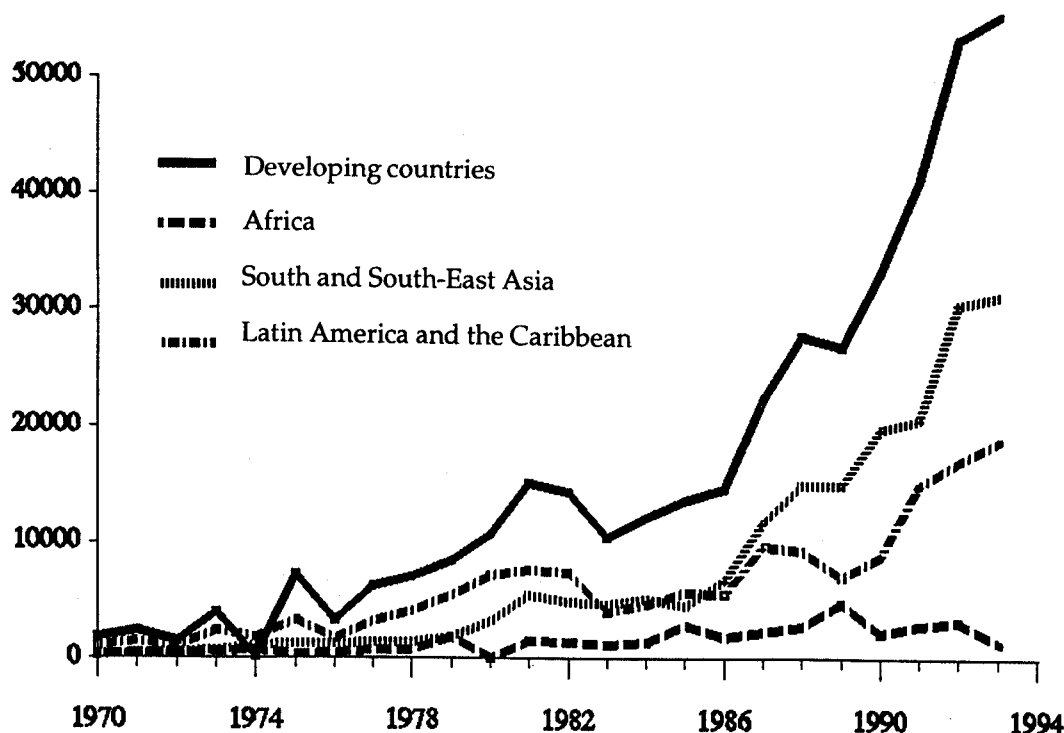
## 2. Foreign direct investment (FDI)

Until the 1980s, Latin America and the Caribbean received the bulk of FDI directed

towards developing countries (see figure III.4). During the 1970s, the flow of FDI into the region was more than double the amount entering Asian developing countries, but this situation was reversed as a consequence of the Latin American and Caribbean debt crisis and the rapid growth of FDI in Asian developing countries from 1986 onwards. These countries were thus able to benefit more from the global increase in FDI that began in 1987 and continues to this day.<sup>42</sup> In the period 1990-1993 these investment inflows into the region amounted to just over half the sum received by Asian developing countries.

<sup>42</sup> In the periods 1970-1974 and 1990-1993, the Asian developing countries' share of world FDI rose from 4.6% to 14.8%. Latin America has seen its share fall from a maximum of 13% in 1975-1979 to 6% in 1985-1989, and rebound to 8.6% in 1990-1993. The region has still not regained the ranking that it had prior to the debt crisis.

Figure III.4  
 FDI FLOWS INTO DEVELOPING COUNTRIES  
 (Millions of dollars)



Source: ECLAC, on the basis of the International Monetary Fund (IMF), *Balance of Payments Statistics Yearbook*, Washington, D.C., various years, estimates by the Organization for Economic Co-operation and Development (OECD) and national sources.

Having lost their relative attractiveness, Latin American and Caribbean countries were obliged to offer powerful incentives or generous subsidies to foreign investors in an effort to correct this downward trend. Table III.9 shows that incentives, in the form of discounts as part of debt-for-equity conversion programmes or privatization programmes, played a key role in regaining FDI levels in the region's principal recipient countries (Colombia was the only significant exception). Over 40% of the FDI inflow into the seven countries included in table III.9 during the period 1988-1993 involved some kind of incentive linked to these programmes.

For the Latin American and Caribbean countries, regaining their share of FDI has thus been a gradual process. All

of the countries in table III.9, which are the region's major recipients of foreign direct investment, had to undertake stabilization and adjustment programmes that included agreements with international financial institutions (the International Monetary Fund and the World Bank, among others) and private institutions (such as the coordinating committees of the creditor banks) that enabled them to offer incentives based on foreign debt conversion and on privatizations.

Incentives played a very important role in promoting the inflow of FDI into Mexico between 1986 and 1988. After that period, "normal" inflows resumed until the crisis of December 1994. Chile had a similar experience, since in the period 1985-1990 FDI inflows into the country

Table III.8  
LATIN AMERICA AND THE CARIBBEAN (5 COUNTRIES): CHARACTERISTICS  
OF PRIVATIZATION PROCESSES

	Privatization (as a per- centage of GDP) <sup>a</sup>	Number of enter- prises privatized	Sequence	Method of sale	Privatization in the context of structural adjustments
Chile Phase I (1974- 1980)	9.7 <sup>b</sup>	557	Firstly banks and manu- facturing enterprises (small and medium- sized)	- Returned to former owners free of charge (325 enterprises) - Direct sale - Tendering	Formed part of structural adjustment
Phase II (1985- 1989)	6.8	39	Large enterprises - Public utilities	- Sale subsidized by people's and worker's capital - Institutional capital (private pension funds) - International tendering <sup>c</sup> - Direct sale - Sale on the stock exchange	Privatization was carried out once the macro- economic adjustment process was consolidated
Mexico (1982- 1994)	8.8	1,155	Firstly small enterprises, then larger ones (banks and public utilities)	- International tendering - Sale to employees - Sale on the stock exchange - Concessions	Privatization did not form part of the adjustment. The process was carried out at an advanced stage of the structural adjustment
Argentina (1990- 1994)	6.9	297	Firstly large telecommu- nications enterprises and airlines	- International tendering <sup>c</sup> - Sale to employees - Concessions	The privatization was carried out in the middle of a macroeconomic adjustment programme. Helped finance the convertibility plan
Peru (1992- 1994)	6.1	83	Firstly small enterprises, then banks and larger en- terprises	- International tendering - Sale to employees	The privatization was implemented at an advanced stage of the structural adjustment programme
Nicaragua (1991- 1994)	6.6	351	Medium-sized enterprises (in the Nicaraguan con- text). Public utilities are expected to be privatized	- Returned to former owners <sup>d</sup> - Sale to employees <sup>e</sup> - Direct sale <sup>e</sup> - Concessions	Privatization was one of a series of structural adjustment measures

Source: ECLAC, "La crisis de la empresa pública, las privatizaciones y la equidad social", Reformas de política pública series, No. 26 (LC/L.832), Santiago, Chile, 1994; *Latin Finance and Privatisation International*, various issues.

<sup>a</sup> Receipts (in cash or in external debt instruments) as a percentage of GDP. <sup>b</sup> Estimate. <sup>c</sup> International debt instruments were often accepted as a means of payment in international tenders. These had a low discount value in the secondary market; for example, in the case of Argentina, the discount value averaged 30% of the par value.

<sup>d</sup> In Nicaragua, there were 1,237 individual privatizations involving 351 enterprises, in 544 instances, businesses were returned to former owners. <sup>e</sup> "Indemnity bonds" issued to those whose businesses had been confiscated were one widely used method of payment; the value of these bonds in the secondary market fluctuated around 20% of their par value.

Table III.9  
**LATIN AMERICA AND THE CARIBBEAN (7 COUNTRIES): FOREIGN DIRECT INVESTMENT  
 (FDI) FLOWS, BY TYPE OF INSTRUMENT, <sup>a</sup> 1988-1993**  
 (Thousands of dollars)

Country/Instruments	1988	1989	1990	1991	1992	1993 <sup>b</sup>	1988- 1993
<b>Mexico</b>							
Total	2 594	3 037	2 632	4 762	4 393	4 901	22 319
Conventional FDI	1 671	2 648	2 432	3 956	4 302	4 901	19 910
External debt conversion	868	389	85	19	0	0	1 361
Privatization	55	0	115	787	91	0	1 048
<b>Argentina</b>							
Total	1 147	1 028	1 836	2 439	4 179	6 305	16 934
Conventional FDI	807	869	-80	1 586	2 112	694	3 658
External debt conversion	340	159	815	0	0	2 984	5 901
Privatization	0	0	1 101	853 <sup>a</sup>	2 067 <sup>c</sup>	2 627	7 375
<b>Brazil</b>							
Total	2 969	1 267	901	972	1 454	802	8 365
Conventional FDI	882	321	618	850	1 359	752	4 782
External debt conversion	2 087	946	283	68	95	50	3 529
Privatization	0	0	0	54	0	0	54
<b>Chile</b>							
Total	933	1 289	590	523	699	841	4 875
Conventional FDI	-15	67	235	563	731	891	2 472
External debt conversion <sup>d</sup>	809	1 107	355	-40	-32	-50	2 149
Privatization	139	115	0	0	0	0	254
<b>Venezuela</b>							
Total	89	213	451	1 916	629	372	3 670
Conventional FDI	39	30	148	161	545	347	1 268
External debt conversion	50	183	303	256	70 <sup>c</sup>	25	889
Privatization	0	0	0	1 499	14	0	1 513
<b>Colombia</b>							
Total	203	576	500	457	790	850	3 376
Conventional FDI	203	576	500	405	790	850	3 324
External debt conversion	0	0	0	0	0	0	0
Privatization	0	0	0	52	0	0	52
<b>Peru</b>							
Total	26	59	41	-7	127	349	595
Conventional FDI	26	59	41	-7	-13	60	166
External debt conversion	0	0	0	0	0	0	0
Privatization	0	0	0	0	140	289	429
<b>Latin America and the Caribbean<sup>a</sup></b>							
Total	7 961	7 469	6 951	11 062	12 271	14 420	60 134
Conventional FDI	3 613	4 570	4 279	6 391	8 232	8 495	35 580
External debt conversion	4 154	2 784	1 912	325	1 645	3 009	13 829
Privatization	194	115	760	4 346	2 394	2 916	10 725

Source: A. Calderón, "Inversión extranjera directa e integración regional: la experiencia reciente de América Latina y el Caribe", *Industrialización y desarrollo tecnológico*, series No. 14 (LC/G.1778), Santiago, Chile, 1993, and other official information.

<sup>a</sup> Seven countries. <sup>b</sup> Preliminary estimates. <sup>c</sup> The external debt conversion activities carried out in 1991-1993 were directly related to privatization. <sup>d</sup> FDI was incorporated by means of chapter XIX of the Compendium of Rules on International Exchange published by the Central Bank of Chile.

were likewise based on incentives (particularly on foreign debt conversion), reassuming a more conventional and permanent character between 1991 and 1993. It can thus be concluded that Mexico and Chile made successful use of incentive programmes as transitional measures to attract FDI until a certain degree of normality had been re-established.

The trends shown by new FDI in Latin America and the Caribbean from 1991 to 1993 indicate that, although incentives were unquestionably important, "normal" inflows increased markedly. Furthermore, these inflows have been heavily concentrated in certain countries and sectors. Until 1993, of the seven countries on which the most data is available (see table III.9), Mexico and Argentina received more than two thirds of the FDI that entered the region (37% and 34%, respectively).

Likewise, in 1991 and 1992 the sectoral distribution of this new FDI showed the following preferences, in order of percentage share: services (41%), manufacturing (29.9%) and natural resources (25.2%). The greatest volume of investment in the service sector went to Mexico (US\$ 7 billion), where it was used for projects related to tourism, communications, finance and professional services; in second place was Venezuela (US\$ 1.5 billion), where FDI was concentrated in privatizations of transport and telecommunications enterprises; and Argentina received US\$ 1.1 billion, which was chiefly used for privatizations in the energy and telecommunications sectors. New FDI in manufacturing went mostly to Mexico (US\$ 6 billion), mainly for restructuring the automotive and *maquiladora* industries (electrical and electronic equipment and automotive parts). In the area of natural resources, US\$ 5.9 billion were invested in major projects in Argentina (petroleum), Colombia (petroleum) and Chile (copper and gold).

### 3. Institutional restructuring and establishment of new standards in the energy sector

The energy sector reforms undertaken in the majority of Latin American and Caribbean countries in the 1990s have similar origins and rationales, though they vary as to orientation and the sharing of responsibilities between the State and the private sector.<sup>43</sup>

The pattern of energy sector development during the 1970s, based as it was on borrowing abroad, led to a dichotomy between energy-specific policies and macroeconomic policies, resulting in serious contradictions in many countries of the region. These conflicts had to do with the role of the energy sector in dealing with inflationary pressures; the impact of price and tariff policies on the financing of the sector; and fiscal management of energy revenue –tariffs were generally frozen for long periods or were set at lower levels than the effective operational cost.

Both subsidies, which were generally non-specific, and the shortfall in tariffs, ended up benefiting the higher income brackets and at the same time contributed to the under-financing of companies in the sector and encouraged inefficient use of energy.

Moreover, price and tariff policies and the allocation of energy revenues in the region were handled with a predominantly fiscal approach which, in many cases, led to a postponement of necessary tax reforms and affected the availability of funds to expand and modernize State-owned enterprises.

The case of oil demonstrates the importance of these revenues in providing fiscal income. Between 1980 and 1990, the Mexican public sector was financed using oil income which accounted for between 9% and 13% of GDP. In Bolivia, the proportion varied from 2% to 9%; in

<sup>43</sup> Chile is a special case, in that energy sector reform took place over a period of time during the 1980s (Tohá, 1995).

Venezuela, it was between 10% and 19% (1988-1992); and in Argentina 1.5% to 3% (1980-1990).

The current reformulation of energy policies essentially seeks to correct prices and tariffs, restructure the finances of publicly-owned enterprises and put them on a sound footing, reorganize and partially deregulate energy markets, carry privatizations through and promote private investment.

The aim of price and tariff correction is to increase companies' share of the final price in order to improve fund availability and lower the incidence of budget transfers. Tax reform is designed to reduce energy revenue's contribution to fiscal receipts, although selective taxes on fuels still account for a significant proportion of such receipts in some countries. Elsewhere, cross-subsidies and the fiscal emphasis persist—the result of efforts to cut budget deficits.

Steps have also been taken to improve operational efficiency and reduce costs by cutting staff. Units have sometimes been closed down or, as with *Petróleos Mexicanos (PEMEX)*, production units have been separated in order to make the yield at each stage of the production process more transparent, and to avoid cross-subsidies between activities.

The aim of reorganizing energy markets has been to put an end to the monopolistic conditions under which the sector developed. Approaches depend, naturally, on the tradability of goods and the contestability of markets (lack of entry or exit barriers). In the case of oil, some countries have favoured liberalizing foreign trade and guaranteeing the free availability of oil, since international reference prices exist which can be used to measure the adequacy of supply. As regards electricity and natural gas, the trend has been to establish competitiveness at the generation stage and to regulate transmission and distribution, which in both cases have the characteristics of a natural monopoly (see box III.1).

The greatest advances in privatization have occurred in the electricity sector, following the pioneering reforms in Chile. Such projects have come to fruition in Argentina and, more recently, in Peru, where in Metropolitan Lima generation and distribution have been privatized, and, in some areas of the interior, distribution has been privatized.

Other countries have opted for a limited form of privatization. In Brazil, a more selective policy has been implemented, while in Mexico private participation is being stimulated in order to expand generating capacity. Generally speaking, most energy policies reflect the feeling that private investment, whether national or foreign, should play a leading role in the restructuring and expansion of the sector. Brazil and Venezuela are lifting restrictions on private investment in hydrocarbons: in Venezuela, bidding recently began under profit-sharing schemes with the State-owned enterprise and Brazil has just abolished the public-sector monopoly.

Oil sector reform is a special case. Supply is diversified, as is normal with energy tradables, and there are worldwide standards for commercial contracting, and international reference prices.

There is a trend at the regional level towards making domestic hydrocarbon markets competitive by promoting private participation and abolishing State monopolies. Thus the market would include public-sector and private companies, with various contracting options, such as partnerships, franchises, licences, profit-sharing schemes and production-sharing contracts, as well as different types of strategic alliances. It is likely that a selection would be made, favouring some options and discarding others, depending on national interests.

In accordance with these guidelines, competition would be introduced into prospecting and extraction, reserves held by State-owned companies would be abolished and the risks involved in prospecting would be borne primarily by private companies, national or foreign.

## Box III.1

REFORM OF THE ELECTRIC POWER  
SECTOR

The general objectives of reform in the electric power sector are fivefold and can be summarized as follows:

i) Reducing the State's entrepreneurial role and directing resources towards programmes and projects which are not attractive to private investment (subsidiary role for the State);

ii) Modifying business arrangements, so that commercial gain -based on setting tariffs equal to the marginal cost- and competitiveness are the factors which stimulate improved operational performance and determine levels of profitability (the market as a byword for efficiency);

iii) Enhancing the country's international image through signals which link the scaling-down and privatization of public enterprises with fiscal deficit reduction and increased availability of resources to service the external debt (macroeconomic stabilization);

iv) Promoting private investment, both domestic and foreign, in order to obtain the financing required for the expansion and maintenance of installed capacity (prominent role for the private sector);

v) Opening up to capital markets in order to tap new sources of financing and as a way of dealing with the reduction in credit from multilateral organizations and the increased selectiveness of private credit providers (expansion of international financial linkages and new domestic forms of saving and investment).

Based on private-sector participation and its legal framework and on the way markets operate, reforms in the electric power sector in the countries of the region are in keeping with two broad models:

**a) Partial opening-up of generation.** This model is typically based on natural or legally protected monopolistic structures, with a single enterprise, integrated both vertically and horizontally, which operates all or most of the generation, transmission and distribution systems. In some instances, separate enterprises handle generation and transmission, and local distribution is the responsibility of provincial or municipal entities.

This model provides for the participation of private capital in electric power generation; co-generators or independent producers must sell the electricity to the electric power companies at controlled prices, and local distributors can purchase electricity from the monopoly.

The system is centrally planned and operated; this makes it possible to optimize functioning through unified load dispatch operating in real time.

In the relevant cases (Mexico and Costa Rica), regulation is independent of the ownership system, and the firm's performance is evaluated on the basis of quantitative targets with respect to a number of variables which determine its economic efficiency and which must be reached within given deadlines.

As regards the setting of tariffs, it has generally been decided to equate basic price levels with average costs and to implement a tariff schedule which to some degree reflects marginal costs (second-best solution).

In the case of Costa Rica, electric power transactions in the interconnected system remain under the control of the Instituto Costarricense de Electricidad (ICE), a State-owned enterprise, and public and private generating companies sell power under the same conditions. This network is unrestricted upstream (generating companies are entitled to sell power using the transmission system) but not downstream (generating companies may not sell power to certain customers), and this limits the type and quantity of market transactions.

**b) Competition in power generation and opening-up of networks.** The basic principle of this model, which is applied in Chile, Argentina and Peru, involves the total openness of the system and deregulation of markets. This means that distributors must not be dependent for supply on a single firm -public or private, integrated or solely a generator- but must be free to purchase electric power from any generating company.

## Box III.1 (concl.)

The situation is the same for bulk users or "free customers", who agree on a price for electric power with the generating company of their choice. The precondition for the establishment of a free and competitive wholesale market made up of generating companies, distributors and bulk users is free access to transmission systems.

A totally unrestricted transmission system and central dispatching are both key elements in ensuring equitable access to the interconnected system for transfer of power *en bloc*.

With respect to division of generation-transmission activity, and involvement of private capital, two models have been followed:

i) In Chile's central interconnected system, the Empresa Nacional de Electricidad (ENDESA), the leading generating company, is also responsible for transmission, through TRANSELEC, and this arrangement could be regarded as a serious impediment to competitiveness; in addition, through ENERSIS S.A., a holding company, ENDESA also controls distribution in the metropolitan area, via CHILECTRA.

Other countries have attempted to avoid allowing the same firms to be active in all stages of the system. In Argentina, one of the high-tension transmission networks is owned by TRANSENER, which operates as an independent corporation. In Peru, the law provides for restrictions of this sort, though it is difficult to prevent intra-firm relations; in Colombia, Interconexión Eléctrica S.A. (ISA) is set to withdraw from generation and transmission, but will remain the owner of the interconnected power system.

ii) In Chile, the private sector is encouraged to participate in all stages of the system, but the State retains ownership of Empresa Eléctrica Colbún Machicura S.A., which currently supplies about 14% of the power used. In Argentina, the trend is towards total privatization of the entities responsible for generation, including hydroelectric power plants shared with other countries (Entidad Binacional Yacyretá) and nuclear power stations. A similar trend has taken hold in Peru.

Bolivia is a special case in that the Capitalization Act seeks to encourage private-sector participation on the basis of a capital widening programme.

Source: ECLAC, *El desarrollo energético de América Latina y el Caribe*, Santiago, Chile, 1995, unpublished.

In the context of a mixed, competitive economy, steps would be taken to guarantee free access to transport networks (oil and gas pipelines), which would inevitably lead to public-sector intervention and regulation, since natural monopolies are involved. Although the size of the domestic market limits the opportunities for competition, entry barriers for refining into liquid fuel would not be set up: instead there would be freedom to import and to negotiate supply on the basis of international reference prices.

Generally speaking, there would be freedom of distribution of fuel, and the opportunity to contract out the marketing of specific brands; at the same time, there would be no restrictions on the opening of fuel sales outlets. This would not dispense with the need for regulations and performance standards in order to guarantee the quality and regularity of supply and to prevent distortions in free competition, which could occur if producers formed a cartel to limit distribution volume or to fix prices (ECLAC, 1995g).

## E. TRENDS IN PRODUCTIVITY

### 1. Total factor productivity

Between 1950 and 1980, total factor productivity rose by an average of 1.2% in the largest countries in Latin America. This figure suggests that technical progress accounted for one seventh of growth during this period. The serious slow-down in growth in the 1980s caused a drop in productivity, owing to underutilization of factors of production (see table III.1, box III.2 and figure III.5).

Total factor productivity has been uneven. After an annual growth rate of 2.3% between 1950 and 1973, productivity remained virtually the same between 1973 and 1980, testifying to the end of the postwar expansion, despite the fact that during the latter period there was sufficient external financing to have revived investment and production efficiency. Total factor productivity fell in the 1980s and began to recover slowly at the beginning of the 1990s. By 1992, Colombia and Chile were the only countries close to regaining their former total factor productivity levels—and, in the case of Chile, exceeding them. This is not surprising since, as has already been pointed out, both these countries had succeeded in overcoming their external and fiscal deficits, and investment had returned to levels recorded before the external debt crisis, or even exceeded them.

### 2. Trends in labour productivity

Labour productivity rose at an annual rate of close to 3% during the 1960s and 1970s (albeit more slowly during the 1970s) as a result of the generalized trend towards greater incorporation of capital into the region's economies. The rate dropped back in the 1980s, but began to rebound in the 1990s in some countries, particularly in Argentina and Chile (see table III.10).

From the 1970s onwards, agricultural productivity has consistently risen in the

countries of the region. It is this trend that is basically responsible for the sector's favourable performance. Nevertheless, there is still a vast difference compared with the developed countries, since the sector is less capital-intensive (there is less mechanization and access to irrigation) and less technically developed (poor land management, scant use of fertilizers or improved seed).

Productivity in large-scale mining in the region has risen remarkably, essentially because of new investment that has brought in the most advanced international technology, which tends to incorporate criteria of environmental sustainability into the process; restructuring of existing mines has also played a part. Small- and medium-scale mining, by contrast, continue to lag considerably in technological terms.

The region's manufacturing, where productivity had attained annual growth rates of from 2% to 3%, was affected by the debt crisis. Nevertheless, worker productivity rose again in the second half of the 1980s, and even exceeded the levels recorded during the 1970s.

During the 1990s, productivity in medium- and large-scale industry has grown at rates unmatched in the two previous decades. This improvement has been based partly on greater utilization of operating capacity but chiefly on changes in the organization of production, which means that it has been achieved with relatively little new investment but considerable technical change of a "disembodied" nature, which has led to a drop in employment.

Service productivity, which had increased progressively during the 1970s, fell throughout the region in the 1980s and during the 1990s has rebounded only in some countries.

### 3. Agricultural modernization

Agriculture has expanded continuously over the last 20 years as a result of the increase in factor productivity, particularly labour and land productivity.

## Box III.2

TOTAL FACTOR PRODUCTIVITY IN  
LATIN AMERICA

One of the most significant advances in growth accounting has been the breakdown of growth into the factors of production (chiefly capital and labour) and technical progress. The latter, is actually a residual factor composed of many other factors; since the late 1950s, a great deal of research has gone into defining these factors, and the amount left to be explained by the residual factor has been reduced.

The concept of total factor productivity (TFP) constitutes a step forward in growth analysis. Total factor productivity is defined as the measure of variation in output per unit of combined inputs: it is thus an indicator of the efficiency of the use of *all* inputs, not labour alone. Solow (1960) proposed accounting for the effects of technological change incorporated in fixed investment in order to improve the measurement of capital. A suggested method for improving the measurement of labour involves taking the average number of hours worked per year, weighting the hours by relative average income, adjusting for changes in age and sex in the composition of labour, and incorporating the contribution of education to growth (Schultz, 1961).

Table III.1 illustrates the results of a growth accounting exercise. For the 1950-1980 period, the average rate of growth of Latin America's GDP was 5.3% per annum, while the corresponding figure for labour, adjusted for education, was 3.6% and for capital 6.2%. After weighting the inputs of

labour and capital by their respective shares in output, total growth in factor productivity is estimated to be about 1.2% per annum.

From 1950 to the present, the region has witnessed a gradual decline in the growth of TFP. The variable increased at a rate of 1.2% per annum between 1950 and 1980, it remained constant from 1973 to 1980 and declined in the 1980s. In the period from 1989 to 1994, however, it experienced a recovery (1.1%).

This trend is in contrast with that observed in other regions, such as the newly industrializing countries (NICs) of Asia and OECD member countries, where TFP not only rose more rapidly, but has continued to do so, even in the 1980s. In Latin America, during the period of greatest dynamism (1950-1973), the rate of growth in TFP was half that recorded in the Asian NICs and the OECD countries. Of the average annual GDP growth rate of 4.3% recorded in Latin America between 1950 and 1994, approximately 35% is attributable to the increase in the quantity of physical capital, while 10% is due to improvements in the quality of labour (explained chiefly by rising levels of education), 31% to increases in employment and only 14% to technological progress. During the 1950-1994 period, the contribution made by technological progress to the region's growth was barely 0.6% per annum, compared with 2.8% in the case of the Asian NICs and the OECD countries.

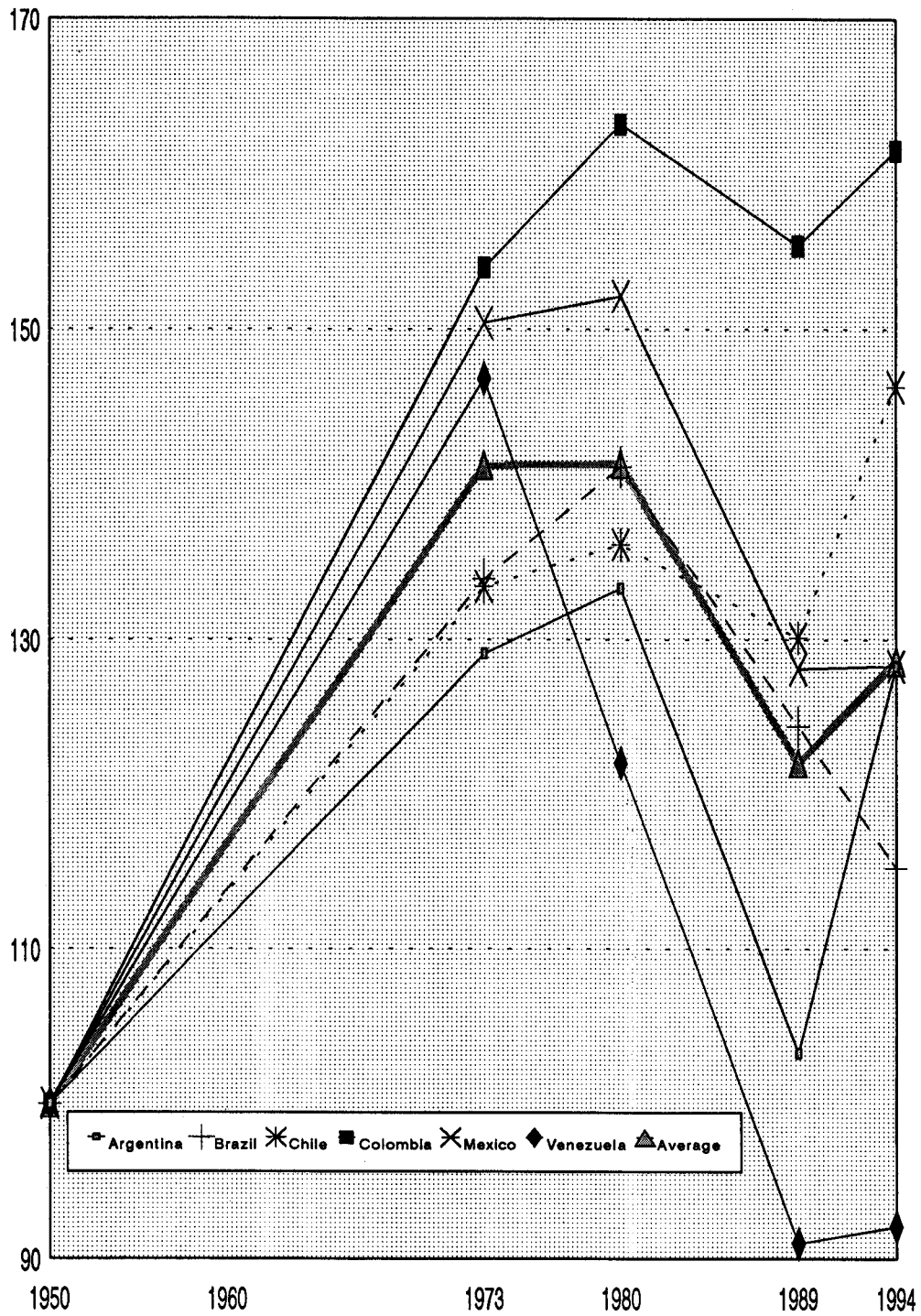
Source: Economic Commission for Latin America and the Caribbean (ECLAC); André A. Hofman, "Economic growth and fluctuation in Latin America. The long run", document presented at the Conference on "Development strategy after neoliberal economic restructuring in Latin America", Miami, North-South Center/University of Miami, 1995 and "Capital stock in Latin America: a 1994 update", *Cambridge Journal of Economics*, forthcoming; R. Solow, "Investment and technical progress", *Mathematical Methods in the Social Sciences*, K. Arrow (ed.), Stanford, 1960 and Th. Schultz, "Investment in human capital", *American Economic Review*, March 1961.

This performance is in line with long-term trends in the region's agriculture. Table III.11 shows some basic indicators of the sector's behaviour, and allows

comparison with the behaviour of the economy as a whole.

The relatively constant rate of increase in productivity suggests that the drop in

Figure III.5  
**LATIN AMERICA AND THE CARIBBEAN (6 COUNTRIES):  
 TOTAL FACTOR PRODUCTIVITY<sup>a</sup>**  
*(Indexes 1950=100)*



<sup>a</sup> The figures for labour include increases in average number of years of education.

Table III.10  
**LATIN AMERICA AND THE CARIBBEAN: LABOUR PRODUCTIVITY, 1970-1993**  
*(Annual percentage variation)*

Sector	Argentina	Brazil	Chile	Colombia	Mexico	Venezuela
<b>1970-1980</b>						
Agriculture	3.2	5.0	3.9	4.2	1.0	3.2
Primary (including mining)	3.4	5.2	4.6	3.2	2.2	-3.6
Industrial	0.5	2.5	0.3	0.5	2.5	-1.7
Services	2.3	2.9	-1.0	0.7	2.1	-1.0
Total	1.8	4.6	0.5	1.9	2.9	-2.7
<b>1980-1990</b>						
Agriculture	0.6	2.0	2.4	1.0	2.7	1.3
Primary (including mining)	0.4	2.5	1.8	3.7	3.2	0.3
Industrial	-0.0	-0.6	2.3	1.5	-1.2	-1.1
Services	-4.2	-2.7	-2.0	-0.2	-3.9	-2.6
Total	-2.6	-1.1	-0.2	1.2	-1.0	-1.9
<b>1990-1993</b>						
Agriculture	1.3	2.0	5.3	1.1	-3.0	2.7
Primary (including mining)	1.5	1.8	4.7	-0.1	-2.8	6.5
Industrial	9.6	0.6	1.4	-2.1	-1.5	2.2
Services	4.1	-1.5	4.9	2.9	-2.6	0.4
Total	5.5	-0.5	3.8	0.9	-2.1	1.8

Source: ECLAC, on the basis of official figures.

agricultural growth rates in the 1980s was due to problems of demand rather than supply. Since exports grew faster than agricultural output, the loss of momentum may have been due in part to a decline in domestic demand and in part to changes in profitability connected with the fall in international prices.

Oil crops –soya and sunflower–performed best, although some of the other commodities, such as meat, maize, vegetables and fruits, also did well. None the less, structural problems remain in the sector. First of all, not only is productivity a long way from the international technological frontier, but the gap has been widening over the last 20 years. Secondly, there is still great heterogeneity in agricultural activity, largely as a result of conditions of access to land, capital and technology. Thirdly, agricultural exports face strong protectionism at the

international level, which makes it difficult even for regional crops with excellent yields in global terms to find their way into certain markets in industrialized countries.

Land and labour productivity have made good progress in the region, but still lag considerably behind those of Europe, the United States, Canada, Japan and some of the other developed countries. The productivity of the agricultural labour force in Latin America and the Caribbean is one third of that of Europe and barely 7% of that of the United States and Canada (see table III.12).

Far from diminishing, this discrepancy widened between 1970 and 1990, since factor productivity grew twice as fast in developed countries as in Latin America. The region's productivity compared to Europe's fell from 41% in 1970 to 25% in 1990, and compared to that

Table III.11  
**LATIN AMERICA AND THE CARIBBEAN: INDICATORS OF AGRICULTURAL  
 PERFORMANCE IN COMPARISON WITH THE REST  
 OF THE ECONOMY, 1950-1994**

	1950-1973	1973-1980	1980-1990	1990-1994
<b>Average annual rates of variation</b>				
Agricultural GDP	3.5	3.6	2.1	2.4
Total GDP	5.4	4.7	1.6	3.1
<b>Total factor productivity</b>				
Agriculture	...	1.7	1.7	...
All sectors	2.3	1.0	-0.1	...
<b>Labour productivity</b>				
Agriculture	...	2.2	1.9	...
All sectors	3.3	1.8	-1.1	...
<b>Exports (volume)</b>				
Agriculture	4.1	2.3	3.1	2.3
All sectors	4.6	0.4	3.4	5.8
<b>Imports (volume)</b>				
Agriculture	5.9	12.2	-0.7	12.0
All sectors	4.4	5.1	-1.9	16.8

Source: ECLAC, on the basis of official figures.

of the United States and Canada fell from 14% to under 10% over the same period. Both comparisons show that the gap widened more for labour productivity and less for productivity per hectare (see table III.12).

This relative lag has various causes. The most important are poor land management, restricted access to irrigation, scant use of fertilizers<sup>44</sup> and, probably, of improved seed, and a low level of mechanization.<sup>45</sup> It can be seen from this that productivity, in terms of both yield per hectare and production per labour unit, has great potential for growth, which can be achieved with the

use of fertilizers, improved seed and irrigation to make the best use of the available land.

Among the factors which explain these differences in productivity is the obvious heterogeneity of agriculture in the region. The most pronounced differences are structural and relate in particular to access to resources such as land and credit; secondly, a variety of agroecological systems exist, ranging from temperate zones to different types of tropical areas; thirdly, international markets introduce distortions; and, lastly, cultural approaches to the prevailing range of technologies vary.

<sup>44</sup> Less than 70 kg of fertilizers are applied per cultivated hectare in the region, compared with over 300 kg in the majority of European countries and Japan (FAO, 1993).

<sup>45</sup> The ratio in Latin America is half a tractor per 100 workers, which contrasts with a figure of between 10 and 17 tractors in Europe and the United States and Canada (FAO, 1993).

Table III.12  
**LATIN AMERICA AND THE CARIBBEAN: PRODUCTIVITY OF  
 THE AGRICULTURAL SECTOR**  
 (1980 dollars)

	Latin America and the Caribbean	Southern Cone	Andean countries	Brazil	Latin America and the Caribbean <sup>a</sup>	Mexico	Europe	United States and Canada
<b>Labour-force productivity (1)</b>								
1970	1 058	3 334	806	984	844	709	1 904	11 571
1980	1 315	4 004	928	1 484	973	789	3 074	14 580
1990	1 588	5 243	1 092	2 007	913	898	4 747	22 561
<b>Output per hectare of cultivated land (2)</b>								
1970	332	285	349	410	499	201	450	218
1980	371	306	405	417	536	268	561	273
1990	428	389	485	447	539	339	577	317
<b>Cultivated hectares per worker (3)</b>								
1970	3.2	11.7	2.3	2.4	1.7	3.5	4.2	53.1
1980	3.6	13.1	2.3	3.6	1.8	2.9	5.5	53.5
1990	3.7	13.5	2.3	4.5	1.7	2.6	8.2	71.3
<b>Average annual rates of variation (percentages)</b>								
1970-1980								
(1)	2.2	1.8	1.4	4.2	1.4	1.1	4.9	2.3
(2)	1.1	0.7	1.5	0.2	0.7	2.9	2.2	2.3
(3)	1.5	1.1	0.0	4.0	0.7	-1.8	1.1	0.1
1980-1990								
(1)	1.9	2.7	1.6	3.1	-0.6	1.3	4.4	4.5
(2)	1.4	2.4	1.8	0.7	0.1	2.4	0.3	1.5
(3)	0.4	0.3	0.0	2.3	-0.7	-1.1	0.3	2.9
1970-1990								
(1)	2.1	2.3	1.5	3.6	0.4	1.2	4.7	3.4
(2)	1.3	1.6	1.7	0.4	0.4	2.6	1.3	1.9
(3)	0.8	0.7	0.0	3.2	0.0	-1.5	3.4	1.5

Source: ECLAC, on the basis of figures supplied by the Food and Agriculture Organization of the United Nations (FAO); figures refer to averages over three-year periods.

<sup>a</sup> Does not include Mexico.

In Latin America, the development of modern agriculture, and of the whole system of agribusiness, has been particularly intense in the last two decades. Many of the activities involved show levels of productivity which are fairly close to those of developed countries.

It is also worth noting that the productivity levels of cultivation or stockbreeding activities carried out by medium- and small-scale farmers in temperate zones compare favourably with those of their counterparts in developed countries. In soya cultivation, for example,

total factor productivity attains levels relatively close to those recorded in the United States and Europe. In sunflower cultivation in the region, productivity is slightly higher than in the United States and somewhat lower than in the European Community.

For crops where small-scale subsistence farming and more varied agroecological systems are the rule, there are vast differences in productivity. A typical case is maize, where the productivity ratio is 1:5 compared with the United States and 1:2.2 compared with the European Community. In dairy production, which is analogous to maize in terms of types of producers and agroecological systems, the disparities are even greater.

Improvements in productivity will depend on choosing appropriate land for different crops. Productivity varies significantly according to what the land is used for: for non-traditional crops (generally speaking, garden vegetables), yield per sown hectare is four times greater than that for traditional crops (generally speaking, cereals or other crops which require a large expanse of land). This difference in productivity between the two types of products increased from 1970 to 1990. The higher yield of non-traditional crops is partly a result of using better-quality land and more irrigation and fertilizers, and managing the crops more efficiently.

Regional agricultural exports continue to centre around products which are slow to develop on the world market. While it is true that there are notable exceptions which demonstrate a great ability to find fresh niches in the markets, the region's share of world agricultural trade has gone down (see table III.13). Between 1980 and 1985 it was nearly 15%; by 1993 it had dropped to 11.2%.

The most vigorous exports in the agricultural sector include:

i) Forestry exports, whose share in OECD imports of forestry products rose from 1.8% in 1980 to 3.2% in 1990;

ii) New export products, such as fresh fruit and vegetables, which are making a

good showing among OECD imports from the region;

iii) Exports of the same goods in a wider variety of forms (fresh, refrigerated, frozen) in response to the varying needs of consumer markets. Export products are also undergoing more processing: the 20 chief agricultural products sold by the region to OECD countries include juices, wood pulp and prepared foods. This shows that if niches in the market are wisely selected, the region has ample room to compete successfully in OECD countries.

#### 4. Investment and productivity in mining

In the last two decades, ores and metals have lost some of their momentum in international trade because the developed countries are consuming them at a slower pace. The slow-down has been constant in the case of aluminium, refined tin, iron ore and nickel, while there have been slight rebounds in the consumption of refined lead and zinc.

Since the early 1980s and continuing into the early 1990s, mining imports of the developed countries have tended to shift from roughly processed ores to metals with higher value added. In general, international trading in these products has shown an increase in level of refinement.

Beginning in the 1980s, the long-term decline observable in international prices for the region's most important mining exports began to accelerate, although there was a partial turnaround in 1994 and 1995. Despite the downward trend, however, mining companies have not posted losses, thanks to new technologies that have reduced unit production costs.

In terms of resource allocation on the international level, there has been a major increase in the share accounted for by the Latin American and Caribbean countries in the production of each of the principal mining products. This tendency has been reflected in an increase in the level of local processing of mining products and in greater domestic productive linkages,

Table III.13  
**LATIN AMERICA AND THE CARIBBEAN: SHARE OF INTERNATIONAL  
 AGRICULTURAL PRODUCTS MARKETS**  
*(Percentages)*

	Share of OECD market			
	1980	1985	1990	1993
Latin America and the Caribbean	14.50	15.10	11.70	11.20
Argentina	2.10	1.90	1.77	1.62
Brazil	4.40	5.20	3.56	3.26
Chile	0.22	0.39	0.63	0.70
Colombia	1.75	1.85	1.12	1.08
Ecuador	0.47	0.57	0.48	0.48
Mexico	1.23	1.37	1.43	1.42
Paraguay	0.25	0.17	0.19	0.09
Peru	0.24	0.24	0.16	0.14
Uruguay	0.13	0.12	0.13	0.13
Other countries	3.71	3.29	2.23	2.28

Source: ECLAC, on the basis of data obtained from the Competitive Analysis of Nations (CAN) software program.

with considerable multiplier effects in the generation of added value.

The region's mining sector has improved its performance from three basic perspectives: in terms of production quantities, in terms of the region's percentage share in overall world production, and in terms of technological development.

Between 1970 and 1974, production quantities of most of the principal mining products grew at much faster rates than GDP. This was the case with iron, aluminium, gold and coal; the situation was similar with copper, tin, nickel and zinc, but in the case of these metals production of the refined metal increased even faster than mine output. Silver and petroleum turned in a reasonably good performance. Altogether, of all the region's principal mining products, only lead did poorly, due to the fact that it is gradually falling into disuse worldwide.

Table III.14 shows the strong increase in Latin America's percentage share in world output of the leading metals. The figures are particularly striking in the case of iron and copper, for absolute value of output, and in the case of gold, for the rapidity with which the region has gained a significant position in world production. It is also interesting to note the even greater increases in percentage shares in refined metals; this trend reflects the tendency of the developed countries to import mining products with greater value added, particularly because of the energy costs and environmental impacts refining activity entails.

In large-scale mining in the region, the level of technology has been keeping pace with international technical progress in the field. This is only true for new investment projects, however, which are now incorporating environmentally sustainable technologies; the old mines are much further from the international

Table III.14  
**LATIN AMERICA AND THE CARIBBEAN: SHARE OF WORLD  
 OUTPUT OF LEADING MINING PRODUCTS**  
 (Percentages)

	1970	1980	1990	1994
Aluminium				
Primary aluminium output	1.4	2.3	5.3	6.3
Copper				
Mining output	15.5	21.4	24.9	30.6
Refined	7.6	12.4	15.7	16.6
Tin				
Mining output	16.8	15.3	29.2	39.6
Refined	2.5	11.7	23.7	22.5
Iron				
Mining output	10.7	14.7	19.8	23.0
Nickel				
Mining output	6.0	9.1	11.5	12.4
Refined	3.4	5.5	9.5	10.3
Gold				
Mining output	2.4 <sup>a</sup>	5.2	9.4	9.2
Silver				
Mining output	30.2 <sup>a</sup>	33.4	35.0	42.6
Lead				
Mining output	12.6	11.9	13.5	15.3
Refined	7.8	7.8	7.8	7.8
Petroleum	12.3	10.6	12.7	...
Zinc				
Mining output	12.5	14.1	16.7	20.0
Refined	3.7	5.5	7.5	8.5

Source: World Bureau of Metal Statistics (WBMS), *World Metal Statistics Yearbook*, various issues, and Metallgesellschaft Aktiengesellschaft, *Metal Statistics*, various issues.

<sup>a</sup> 1974.

technological frontier. Small- and medium-scale mining is far behind in environmentally sustainable technologies.

The mining industry worldwide is showing a general tendency towards a concentration of ownership, of which the big transnational firms have an increasing share. Their business strategies tend to be more selective and more sensitive to the political and economic situations of the countries with the greatest mining potential, because the gradual decline of international prices of the principal mining products from the mid-1970s to

the late 1980s has whittled down their profit margins.

The big firms have responded to the decline in profit margins by introducing new technology in all phases of the production process. The exhaustion of high-grade ore reserves in the world's industrialized regions has shifted mining attention towards the developing countries, which still have attractive potential in the form of high-grade ores and megadeposits that can now be exploited, thanks to technological advances in the field.

The above trends have worked to Latin America's benefit. The transnational firms that have established themselves in the region, attracted by its natural advantages, financial liberalization, policies to promote foreign investment and favourable changes in mining laws, are introducing advanced technologies that make it possible to exploit ores that were previously unprofitable due to their low grade or other characteristics. Moreover, these firms are displaying a more responsible attitude towards the environment.

The chief technological advances observable in Latin America relate to two metals in which the region has a strong position worldwide, namely, copper (31%) and gold (9%). In both cases, it is anticipated that production will increase through the development of large deposits in Peru, Chile, Venezuela and Brazil.<sup>46</sup>

To sum up, mining activities in Latin America have entered a highly dynamic phase, for three basic reasons:

i) The region's mineral deposits offer higher yields than the world average. Moreover, large-scale mining methods are up to date with international technical progress, and this makes it possible to exploit the potential of these deposits more intensively.

ii) There are changes occurring in mining on a global level because of the gradual decline of production in the major developed countries due to the exhaustion of ore deposits and the energy and environmental costs involved.

iii) With the striking exception of Chile, where basic reforms were introduced in the mid-1980s, many of the countries of the region –including Argentina, Bolivia, Ecuador, Peru and

Mexico– have only recently started to promote investment, step up the development of new deposits, increase and diversify exports and thereby increase their share of the world market.

Investors have responded very positively. By the mid-1990s investment commitments totalled some US\$ 14 billion for projects to be carried out by the end of the century. Since investment commitments worldwide are estimated at US\$ 41 billion, a third of the total is thus destined for the region, allowing it to embark on a new round of mining investment and to expand its export supply significantly (see table III.15).

### 5. Industrial restructuring and productivity

In the late 1970s, the volume of manufacturing exports began to grow strongly (by around 7% per annum), even though overall manufacturing production was virtually stagnant.<sup>47</sup> These trends showed that the external sector was becoming the more dynamic component of demand and furthermore that many firms were able to redirect their output to foreign markets.

In the second half of the 1980s, some countries (Chile, Colombia and Costa Rica) began to show signs of revived economic activity. In the 1990s, others joined in this new recovery phase (Argentina, Bolivia, Ecuador and more recently Brazil).

The trend in manufacturing productivity has been quite positive. By the second half of the 1980s productivity was already increasing faster than during the previous decade, while in the 1990s productivity rose to even higher rates than in the two preceding decades, although

<sup>46</sup> Progress in hydrometallurgy has revolutionized copper production; sulphuric acid leaching, now associated with solvent extraction and electrowinning (SX-EW), has reduced production costs far below the costs of conventional technologies employing the flotation, casting, refining sequence. Technological changes have caused a reappraisal of deposits of copper oxides and deposits containing secondary sulphides; moreover, by eliminating the casting process, the new methods have brought great improvements in terms of costs and environmental control.

<sup>47</sup> With regard to Latin American manufactures, see ECLAC (1993a); with regard to productive restructuring and development, see ECLAC (1994b).

Table III.15  
**WORLD MINING INDUSTRY: INVESTMENT PROJECTS, 1995-2000**

	Latin America and the Caribbean	Asia	Africa	Australia/ Oceania	Europe	North America	Total
<b>Number of projects</b>							
Aluminium	2	5	3	0	2	0	12
Copper	19	10	1	3	3	11	47
Ferrous ores	1	2	0	1	0	2	6
Gold	8	7	4	8	1	20	48
Iron	1	3	3	2	1	1	11
Lead/zinc	0	1	1	3	2	4	11
Other	10	6	9	2	1	7	35
<b>Total</b>	<b>41</b>	<b>34</b>	<b>21</b>	<b>19</b>	<b>10</b>	<b>45</b>	<b>170</b>
<b>Millions of dollars</b>							
Aluminium	740	2 920	3 680	0	510	0	7 850
Copper	8 740	3 144	9	171	525	2 275	14 864
Gold	708	786	831	1 076	102	2 181	5 684
Iron	1 300	440	1 035	589	0	75	3 439
Lead/zinc	0	25	100	190	76	269	660
Other	2 403	1 887	1 312	1 215	311	1 667	8 795
<b>Total</b>	<b>13 891</b>	<b>9 202</b>	<b>6 967</b>	<b>3 241</b>	<b>1 524</b>	<b>6 467</b>	<b>41 291</b>

Source: MacLean Hunter Publishing Co., *Engineering and Mining Journal*, January 1995.

the performance of the large economies weighed heavily in these results (see table III.16). At this point, the productivity gap between the region and the United States, whose productivity growth can be taken as representative of the speed of change at the international leading edge, slowly started to narrow.<sup>48</sup>

In most industrial sectors, however, the improvement in labour productivity was achieved without major new investment and caused a drop in employment. For the most part, it was achieved through "disembodied" technological changes related to organization and not requiring new capital equipment, although their implementation did entail some complementary investment.

Industrial exports, which played a very important role in the 1980s, continued to expand into the 1990s in both volume and value, despite the decline in the prices of many of the region's basic export commodities, such as copper, paper pulp and fish meal, among others. Industrial imports, meanwhile, which had declined considerably during the first half of the 1980s, resumed vigorous expansion. As a result, the slight trade surplus achieved by the manufacturing sector in 1985 shifted back to a deficit by 1990 and deteriorated considerably in the years that followed to a point exceeding the deficit posted in 1980 (see table III.17).

To sum up, the situation of the industrial sector in the mid-1990s is characterized by an increasingly

<sup>48</sup> In 1970, for example, the productivity of a sampling of the region's industry (Brazil, Argentina, Mexico, Chile and Colombia) was 25% of that of the United States, whereas in 1980 it was 33% and in 1993 28%.

Table III.16  
**LATIN AMERICA AND THE CARIBBEAN (12 COUNTRIES): VALUE ADDED  
 PER WORKER IN MANUFACTURING**  
*(Average annual rates of variation)*

	1970- 1980	1980- 1985	1985- 1990	1990- 1993	1985- 1993
<b>Total</b>	<b>1.6</b>	<b>0.6</b>	<b>1.9</b>	<b>6.4</b>	<b>3.6</b>
Argentina	3.1	0.3	4.1	10.7	6.5
Bolivia	-2.5	3.1	6.8	4.6	6.0
Brazil	2.4	-0.4	1.3	8.8	4.1
Chile	2.8	0.8	-3.1	2.6	-1.0
Colombia	1.8	4.1	2.6	1.9	2.3
Costa Rica	1.5	-2.1	-0.9	2.0	0.2
Ecuador	0.9	4.5	-5.8	-0.2	-3.8
Guatemala	2.4	0.3	1.4	-6.4	-1.6
Mexico	2.7	2.1	4.3	3.4	4.0
Peru	-0.1	-1.4	-3.3	2.5	-1.1
Uruguay	-1.2	-0.1	-1.0	-3.1	-1.7
Venezuela	-4.0	1.7	-0.8	1.2	-0.1

Source: ECLAC, on the basis of official figures.

widespread revival of growth capacity, productivity gains, greater export capacity than in earlier decades, strong expansion of imports of manufactures and a considerable deficit in the balance of trade in manufactures.

#### 6. Inefficiency in the conversion and use of energy

The Latin American and Caribbean countries have greater energy potential, in relative terms, than other developing regions. It is estimated that the region possesses some 35% of the total potentially harnessable energy in the world; Asia and Africa possess 25% and 15%, respectively, and the remainder is divided among the rest of the world.<sup>49</sup>

Of these reserves, 36% relate to hydropower, 27% to coal, 24% to oil, 8% to natural gas and the remainder to other

sources of energy. Just a few countries, however, enjoy comparative advantages, due to geographic, climatic and topographic factors. The countries of South America, for example, have 85% of the region's energy potential, and that of Brazil has a third.

Latin America and the Caribbean are far from achieving adequate levels of efficiency in the conversion and use of energy. The indicator of energy intensity—energy consumption per unit of product—has remained high due to the underutilization and obsolescence of the industrial base, the increase in the number of motor vehicles and the widespread use of inefficient equipment to supply household energy needs.

After the international crisis in oil prices during the 1970s, the industrialized countries adopted austerity measures and tried to find substitutes that would reduce

<sup>49</sup> The concept of energy reserves involves not only the existence of resources but their potential to be exploited profitably; hence, the level of energy assets may vary depending on international prices. The energy reserves of Latin America and the Caribbean are on the order of  $68.7 \times 10^9$  TOE (tons of oil equivalent), with a reserve/production ratio of 134 years (ECLAC, 1993d, pp. 36 to 40).

Table III.17  
**LATIN AMERICA AND THE CARIBBEAN: INDUSTRIAL EXPORTS  
 AND IMPORTS**  
*(Millions of dollars)*

	1970	1980	1985	1990	1992
Exports	5 048.8	32 040.0	37 244.2	61 423.7	69 598.0
Imports	10 183.4	62 071.1	36 191.0	68 718.8	109 467.0
Trade balance	-5 134.7	-30 031.1	1 053.2	-7 295.1	-39 869.0

Source: ECLAC, on the basis of official figures.

energy intensity, and particularly oil consumption, in both social and industrial applications, without diminishing quality of life or economic growth.<sup>50</sup>

The results were significant and contrasted sharply with the situation in the region. Over the past 20 years energy intensity has diminished by 20% for the OECD countries as a whole. In Latin America and the Caribbean, on the other hand, progress over the same period has been modest. The considerable reduction of 9% in energy intensity achieved during the 1970s was reversed by the opposite trend in the years that followed. As a result, by 1993, the region was consuming 7% more energy than in 1980 to produce one unit of output.

The energy path, which relates the trend in energy intensity to the trend in per capita output, depends on the social and productive characteristics of each country and the level of development it has reached. In more advanced economies, the path may slope downward, reflecting a gradual increase in energy efficiency –due to technological changes or to changes in productive structures in favour of less

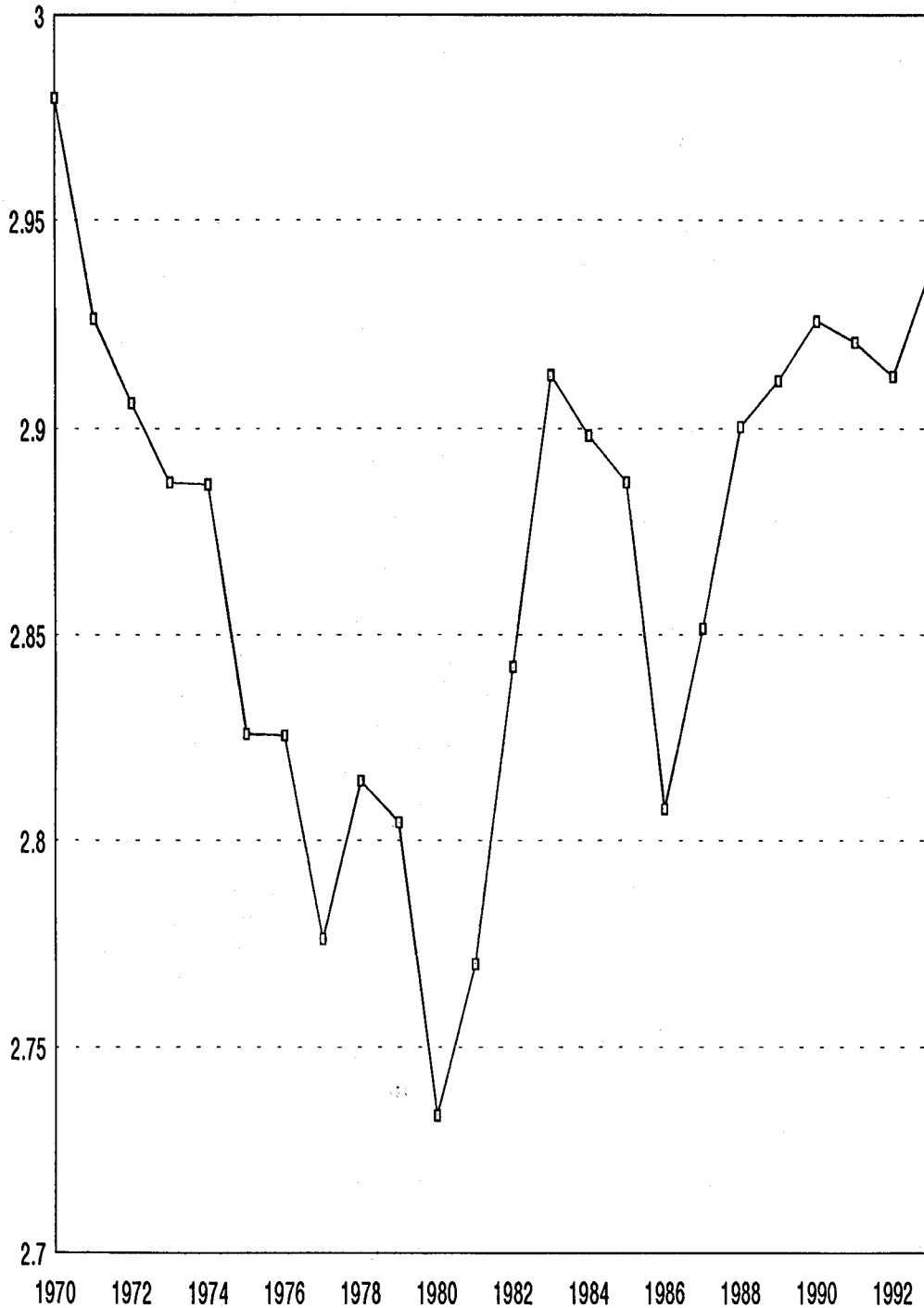
energy-intensive activities– as per capita income increases. In relatively undeveloped countries, on the other hand, the increase in per capita income tends to be associated with greater energy intensity; this translates into an up-sloping line, which reveals the energy inefficiencies of the technologies used (see figure III.6).

The energy intensity indicator for Latin America and the Caribbean has followed an erratic path. It moved sharply upward during the period 1980-1985, due to the decline in per capita income, a movement repeated between 1987 and 1990. In the first three years of the 1990s, the trend was interrupted because of a rebound in per capita income, but energy intensity has tended to level off.

The region's scant progress in efficient use of energy is due to a number of constraints that still prevail. First of all, energy conservation measures have not found a place on national agendas, or when they have, they have not turned out to be attractive from an economic standpoint because of the tariff policies and price subsidies applied in previous decades. In many countries there is no

<sup>50</sup> These measures included interventions both on the supply side, with the aim of diversifying the energy supply and replacing petroleum, and on the demand side, with the aim of rationalizing consumption, promoting more effective and efficient uses of energy and discouraging waste. Regulations were passed concerning temperature levels in public places and the consumption of hot water for personal use and domestic heating; technical standards were set for new buildings; publicity campaigns were run to discourage energy waste and promote investment in energy-saving devices and measures; funds were allocated to research and development on efficient uses of energy and on exploitation of alternative, renewable energy sources.

Figure III.6  
**LATIN AMERICA AND THE CARIBBEAN (25 COUNTRIES): ANNUAL  
 TRENDS IN ENERGY INTENSITY<sup>a</sup>**  
*(BOEs per thousand dollars of output at constant 1980 prices)<sup>b</sup>*



a Energy intensity refers to energy consumption per unit of GDP.

b One BOE (barrel of oil equivalent) is equal to 0.13878 TOE (ton of oil equivalent).

clear delegation of responsibilities in the energy sector, the laws are inadequate and efforts are sporadic. Moreover, both government and enterprise are still limited in their technical capacity to apply the new standards.

Tax and credit policies have not encouraged firms and households to introduce energy-efficient technology. There are few information campaigns to create awareness of the importance of energy efficiency.

Another factor that has not helped the situation has been the emphasis on supply, due to the pressure exercised by the constant gap between a slowly increasing supply of energy and demand, in large part subsidized, that is growing too rapidly. This is a clear case of underutilization of price as a tool, and the cost is high, not only in terms of productive and energy efficiency, but also in terms of equitable distribution, since indiscriminate subsidizing of energy demand is clearly regressive. Moreover, the inadequacy of the resources allocated to maintaining the electricity generation infrastructure and the large amount of energy lost in the distribution systems are two more factors that help to explain why Latin America and the Caribbean are lagging behind in energy efficiency.

#### F. ECONOMIC CONCENTRATION AND STRUCTURAL DIVERSITY

So long as the "inward-looking growth pattern prevailed, structural diversity characterized the productive systems of all the countries of the region. Not only were there vast differences in productivity within each sector, as a result of the great variety of production methods and levels of technological development, but the differences persisted even during processes of growth and modernization that were often quite rapid.

On the whole, during the 1980s, this rise in structural diversity was reflected chiefly in sharp declines in labour

productivity in the service sector (see table III.10 and figure III.7). A large segment of the labour force, affected by the increased vulnerability of employment during this period, sought refuge in tertiary-sector activities characterized by low productivity.

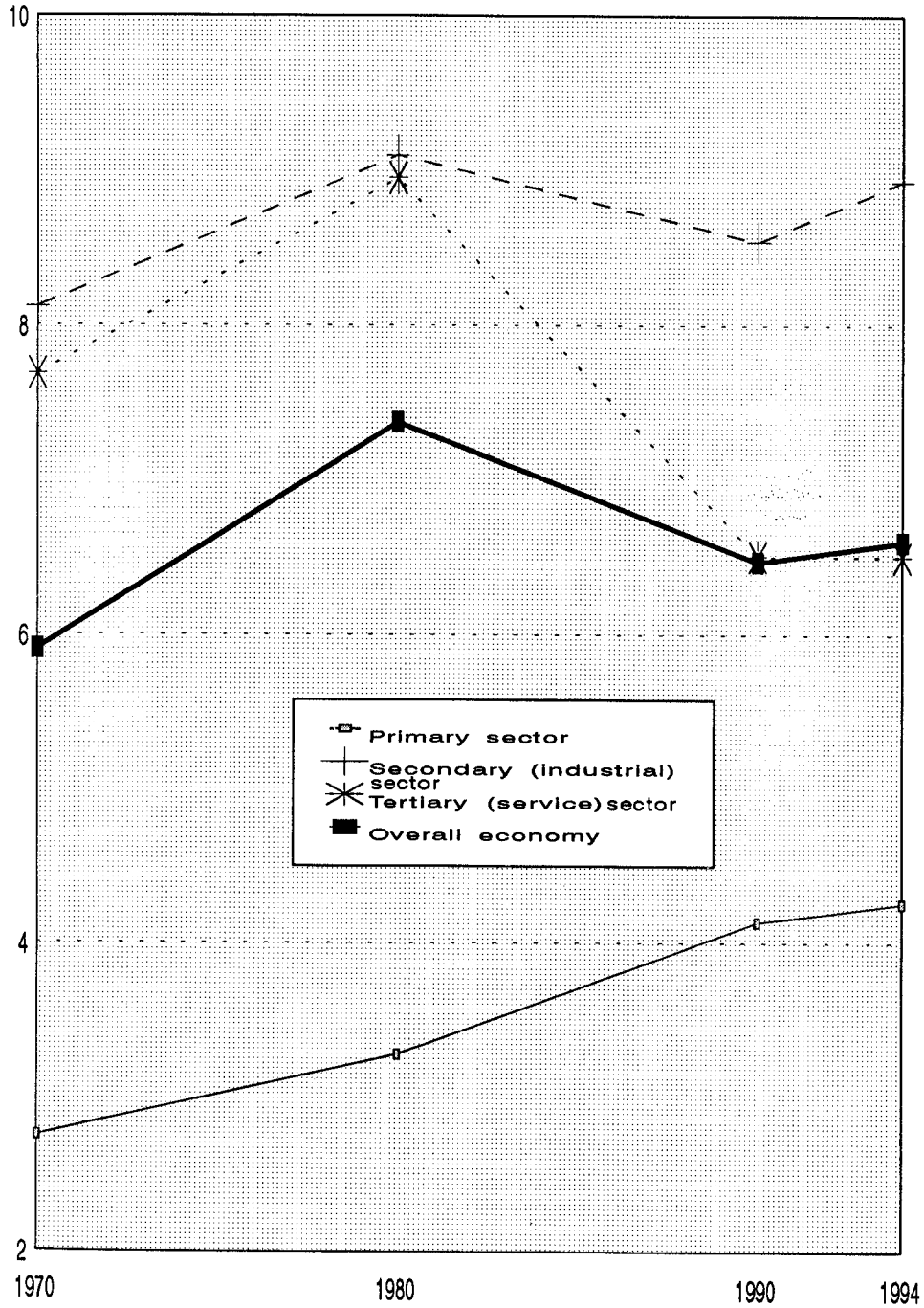
During the phase of growth and transformation of the development mode that began in the 1990s, there have been signs of an increase in economic concentration and structural diversity, as reflected in differences in productivity within a given sector, at least for non-agricultural activities.

Although there are still huge differences in productivity between small-scale farming and commercial agriculture, as a result of unequal access to land, water for irrigation and lags in technology incorporation, agricultural modernization has made notable strides in recent decades and has affected significant groups of producers. The productivity of crop-growing and stockbreeding, activities carried out mainly by small- and medium-scale producers in temperate-zone ecosystems, is close to that of similar activities in developed countries. Furthermore, modern agribusiness systems, representing a new form of internationalization, are emerging within commercial agriculture in the region. Nevertheless, in cropping patterns typical of subsistence farming, which are spread out among highly diverse agroecological systems, the differences in productivity as compared with international standards are enormous. The overall picture, however, also includes promising experiments based on links between modern and lagging sectors (see box III.3).

In the mining sector, small- and medium-scale enterprises clearly do not share in the sector's overall health. These enterprises are increasingly being outpaced by large-scale mining, which, in terms of technology, is on the international frontier occupied by only a few transnational corporations.

As to manufacturing, the steep rise in productivity during the 1990s has centred on medium- and large-scale industries.

Figure III.7  
**LATIN AMERICA AND THE CARIBBEAN (6 COUNTRIES): LABOUR  
 PRODUCTIVITY BY SECTOR**  
*(Thousands of dollars at 1980 prices)*



## Box III.3

**EL SALVADOR: PRODUCTIVE LINKAGES BETWEEN  
SMALL-SCALE GROWERS AND A TRANSNATIONAL  
CORPORATION**

Del Tropic Foods exports frozen vegetables (okra and black-eyed beans (*vigna sinensis*)) to the United States (95%) and Europe (5%). The firm's annual exports amount to 5,000 metric tons.

The small-scale export vegetable growers associated with this firm are, for the most part, individual small-holders who belong to a cooperative founded under the 1980 agrarian reform. Their average crop areas range from 1.0 to 1.5 hectares. They have traditionally engaged in the production of basic grains, and it was Del Tropic Foods which urged them to grow vegetables for export.

As a result of their formal, stable relationship with Del Tropic Foods, the growers have been able to:

- i) Diversify their output by growing okra and black-eyed beans, thus making better use of their land over the year, which has substantially increased their incomes;
- ii) Introduce innovations in crop management, since they have had to adapt to a strict growing schedule and to the use of advanced-technology fertilizers and pesticides, in accordance with the stipulations of their contract with the company.

In addition, the growers will be able to apply the scientific knowledge about pests which they have acquired to their traditional basic crops, such as common beans. It is noteworthy that sowing times, the staggering of sown areas under cultivation and thus, harvesting rates, all play a role, not only in the organization of production within the agro-processing firm, but also in the operations of distributors in the importing country.

Del Tropic Foods signs a contract with the growers in which it fixes a price *ex ante*, based on international prices; the stability of international prices in recent years has benefited growers, prompting them to maintain productive linkages with Del Tropic Foods.

The firm supplies the growers with fertilizers at below-market prices and gives them prompt technical assistance on an ongoing basis. All these factors have helped to sustain the suppliers' interest in signing contracts year after year, which fosters specialization among them and, over the long run, promotes their technological independence. This process entails a steady decline in costs to the firm.

Source: ECLAC, *Las cadenas agroindustriales y la diversificación agrícola en El Salvador*, November 1995, unpublished.

Since small-scale industry has made little or no progress in this area, the gap between the different levels is continuing to widen.

If the 1990-1993 variations in productivity, within the secondary sector as a whole (mining, manufacturing and construction) (see table III.10) are compared with the rates of increases in productivity in large- and medium-sized industrial enterprises (see table III.16), it is evident that the second series outstrips the

first, in some cases by a wide margin. Furthermore, bearing in mind the increases in productivity in large-scale mining, it is possible to conclude that during this period of recovery and growth, labour productivity in small- and medium-scale industry, construction and, probably, small-scale mining, has dropped significantly.

Within the tertiary sector, activities such as telecommunications and financial

services are undergoing profound restructuring in many countries of the region, which translates into strong increases in productivity. In some countries, such as Argentina, Colombia and Chile, these initiatives have led to considerable improvements in average labour productivity in the tertiary sector. At the same time, however, what tends to happen is that the increase in employment in the sector as a whole continues to be driven by the expansion of activities characterized by lower productivity (own-account, non-professional and non-technical work, microenterprises). The coexistence in some countries of two dissimilar trends—a strong drive towards modernization in the case of some tertiary-sector activities, and a tendency towards the expansion of informal activities—indicates that the differences in productivity within this sector are widening.

It is also clear that there is a greater concentration of industrial production in companies belonging to large domestically owned or transnational conglomerates. This situation is due partially to the greater capital density which the redoubled vigour of commodities industries implies, and also to the concentration of vast financial resources and the earning of capital gains and new quasi-rents by a small number of large, multisectoral, entrepreneurial conglomerates, which emerged in most countries during the structural adjustment and reform processes (see box III.4).

## G. EVOLUTION OF INTERNATIONAL COMPETITIVENESS

### 1. Export diversification and strength

Between 1970 and 1990, the volume of exports from Latin America and the Caribbean<sup>51</sup> expanded steadily, at an average annual rate of over 6%. This

increase was higher than that of gross domestic product (GDP) during the 1970s and, obviously, during the crisis in the 1980s. In terms of purchasing power, however, the growth of exports was eroded by the drop in the terms of trade (ECLAC, 1995a).

From the mid-1980s onwards, as world trade accelerated, so did exports from the region. In some countries the rate of growth of export volumes rose significantly (Bolivia, Brazil, Chile, Colombia, Costa Rica, Peru and Venezuela), particularly during the 1990s (ECLAC, 1995a) (see table III.18).

In the great majority of cases, the real prices of the region's leading exports, which have shown a long-term declining trend, have militated against export growth. From 1990 to 1995, only bananas and zinc displayed relative prices higher than in 1980; the products whose prices fell less dramatically as compared with 1980 (nearly 13% on average) were copper and iron. Other products showed far more serious losses in relative prices—up to 40%, in some cases. It should be pointed out that 16 of the 18 leading export products have experienced a steady, long-term decline, meaning that their relative prices have fallen for over 10 years, on average, which has forced the countries to redouble their exporting efforts in order to improve their external balances. Assuming that the exports of the region's countries were composed of equal shares of the products listed in table III.19, the average real loss in relative prices during the first half of the 1990s, as compared with the base year, would be almost 36%.

These adverse developments affected not only homogenous primary products, or commodities, but also industrial goods. Indeed, according to a recent analysis of trends in the real price index for a wide range of such goods, as compared with the index for manufactures, their 1992 prices were the lowest in 90 years (Borensztein et. al., 1994).

<sup>51</sup> Venezuela is not included in order to partially cushion the effect of the fluctuations in fuel prices and volumes seen during this period.

## Box III.4

ECONOMIC REFORMS AND CORPORATE  
RESTRUCTURING

Adjustment processes and the policies of liberalization, economic deregulation and privatization have had unequal effects on the various economic agents, industries and regions within each country. This has accentuated the performance distinctions between firms and thus the traditional structural diversity of the Latin American and Caribbean productive systems.

From this standpoint, it is important to distinguish among four major corporate categories. State-owned enterprises, domestically owned small- and medium-sized enterprises, local subsidiaries of transnational firms and domestically owned groups of companies, vertically and horizontally integrated into conglomerates which are characterized by strong diversification. The changes wrought by the adjustment processes and the new policies have had a greater impact on State-owned enterprises and domestically owned small- and medium-sized enterprises, while local subsidiaries of transnational firms and large domestically owned conglomerates appear to have benefited the most from the recent transformations.

Major areas of economic activity (energy generation and distribution, telecommunications, transport, ports), along with a variety of industries (iron and steel and petrochemicals, among others), have gradually been transferred to the private sector, which is governed by regulatory frameworks that differ from one country to the next and are often rather loose (Gerchunoff, 1992).

In a number of cases, privatization processes have been motivated by fiscal requirements and by reasons of microeconomic efficiency, which has led to situations of imperfect competition and inspired renewed efforts to regulate and promote competition.

New business opportunities have been opened up, both in fields traditionally barred to foreign capital (iron and steel, petrochemicals and mining) and in agro-based industry and commodities production based on intensive use of natural

resources. Long-established transnational firms, as well as new ones, have responded to this institutional change by setting up new industrial facilities and marketing firms—either owned outright or in strategic partnership with large local groups of companies—and by acquiring pre-existing assets through debt-equity conversion or new investment.

Domestically owned groups of companies are loosely defined organizations whose annual turnover—in Mexico, Argentina, Brazil and Chile—starts at a minimum of US\$ 200 million and can exceed US\$ 4 billion or US\$ 5 billion. Owing to their economic and strategic importance, they have filled the vacuum left by State-owned enterprises and, together with new and reorganized subsidiaries of transnational corporations, are becoming the leading agents of the productive model that is being established, particularly in manufacturing and services.

Domestic capital has a major stake in these organizations, which often control some 20 or more horizontally and vertically integrated firms, although one activity always predominates. In recent years, they have undertaken an organizational restructuring process culminating in the establishment of holding companies, in which strategic functions are clearly distinguished from operational ones. The professionalism of their managerial and administrative personnel is increasing, and their international financial operations are growing more elaborate and complex, as they gain a foothold in the leading international financial markets. They differ from the domestically owned medium-sized enterprises of the 1960s and 1970s in terms of their corporate dimensions, forms of organization, technical and productive resources and major market power in their areas of operation. Although they are generally active in a range of markets, they show a clear preference for industries based on natural resources, energy generation and distribution, services and, to a lesser extent, purely industrial activities.

## Box III-4 (concl.)

The size of these companies' turnover, their technological and organizational development and the gradual expansion of the domestic market during the 1980s drove them to expand externally, through exports of goods and services and direct investment in foreign markets. In Brazil, Mexico, Chile and Argentina, such firms have become the leading exporters, and can also take credit for the nascent process of external investment seen in these countries. The expanded trade areas resulting from integration initiatives such as MERCOSUR and

the North American Free Trade Agreement (NAFTA) offer fertile ground for their transnational efforts, which are often made in strategic alliance with other local groups or in partnership with transnational corporations in the developed countries.

Economic reforms, by changing the basis of production, are bringing about changes in both the market strategies or corporate players and their relative strength in the productive system, thus increasing its diversity.

Source: Economic Commission for Latin America and the Caribbean (ECLAC); P. Gerchunoff (ed.), *Las privatizaciones en la Argentina. Primera etapa*, Buenos Aires, Instituto Torcuato di Tella, 1992.

On average, the rates of variation in real prices as a whole have tended to remain steady. Some individual markets, however, display greater instability, as can be seen in rates of variation of over 20% in many countries for many periods (see table III.19). For example, some countries of the region export mainly sugar, coffee, cocoa and cotton, which are among the products most affected by variations in real prices; thus, their economies have been subject to significant external fluctuations which have had a negative effect on their stability. The evidence presented in table III.19 is corroborated by other analyses of trends in the prices of basic industrial goods (Borensztein et al., 1994); moreover, it is clear that in recent decades the instability of these prices has been greater than at any other time in this century.

The negative trends in the prices of the main export products have led to continuous losses due to fluctuations in the terms of trade, and have also contributed to the external instability of the countries of the region. The variability of external prices and their downward trend have had an adverse impact on Latin

America. During the 1970s and 1980s, unit export values were subject to sharp fluctuations, particularly during the 1970s, when the rates of variation were substantially higher. From the second half of the 1980s onwards, this situation has improved somewhat, although the rates of fluctuation in external prices have remained above those noted in the 1970s. The fluctuations in unit export values, meanwhile, continue to be several times greater than in unit import values, as can be seen in table III.20.

At the same time, a process of greater economic integration has taken place within the region and externally, which has also significantly reduced the concentration of each country's exports on a few products and shifted the export mix towards products with higher added value and, to some extent, a higher technological content requiring higher skill levels. As a result, the share of commodities in total exports has dropped, while that of semi-manufactures and basic industrial goods has risen substantially, as has the share of industrial products with a higher technological content (see table III.21).

Table III.18  
**LATIN AMERICA: GROWTH OF MERCHANDISE EXPORTS  
 AND GROSS DOMESTIC PRODUCT, 1970-1995**  
*(1980 dollars; annual growth rates)*

	1971-1980			1981-1990			1991-1995		
	GDP	Exports		GDP	Exports		GDP	Exports	
		Volume	Pur- chasing power		Volume	Pur- chasing power		Volume	Pur- chasing power
Argentina	2.8	4.4	6.0	-0.8	8.2	3.9	5.7	7.1	6.6
Bolivia	3.9	-0.7	10.1	0.2	1.8	-2.0	3.6	9.3	4.3
Brazil	8.7	8.5	6.3	1.7	7.2	5.2	2.7	7.1	8.7
Chile	2.7	8.1	4.4	3.0	6.8	5.6	7.1	9.7	12.0
Colombia	5.4	4.8	6.3	3.7	6.5	7.6	4.3	5.4	7.7
Costa Rica	5.5	4.0	4.9	2.4	4.6	4.4	4.5	11.1	10.1
Ecuador	9.0	22.5	15.9	1.9	7.0	5.0	3.4	8.8	5.6
El Salvador	2.7	5.2	6.7	-0.4	-2.5	-7.7	5.5	14.9	22.7
Guatemala	5.7	6.6	7.9	0.9	-0.4	-1.3	4.1	5.8	7.3
Haiti	4.8	7.8	7.6	-0.4	8.0	5.0	-5.8	-9.3	-8.6
Honduras	5.7	4.4	4.8	2.3	1.3	1.7	3.3	0.4	3.9
Mexico	6.7	11.0	15.6	1.7	9.3	5.9	0.7	10.5	8.2
Nicaragua	0.8	0.4	-1.1	-1.2	1.0	-1.2	1.4	6.5	4.3
Panama	5.4	51.4	40.5	0.8	1.1	2.3	4.9	10.4	7.8
Paraguay	8.7	8.1	7.3	3.2	13.7	17.7	3.0	5.5	11.5
Peru	3.9	3.1	3.6	-0.9	-1.3	-3.6	5.5	8.3	8.5
Dominican Republic	7.1	5.7	5.2	2.5	0.5	-3.7	3.8	-0.7	1.9
Uruguay	3.1	6.6	2.0	0.6	5.7	5.8	3.4	2.7	2.8
Venezuela	1.9	-5.1	13.6	0.5	2.0	2.0	2.9	4.7	-0.7
Latin America (18 countries)	5.6	2.4	6.9	6.9	5.4	3.0	3.0	7.9	7.2

Source: ECLAC, on the basis of official data.

According to previous studies (Fajnzylber, 1991), the Central American countries, with the exception of Costa Rica, suffered a setback in their international trade links during 1980-1989. Nevertheless, despite a loss of competitiveness in the OECD market, the subregion showed different results for 1990-1993, registering gains, in its international linkages, particularly with its major market, the United States (see box III.5 and table III.22).

In conclusion, the region's economies show a significant reorientation to external trade, based heavily on a more

intensive exploitation of natural resources. Their export ratio rose from 14% of GDP in 1980 to 21% in 1990 and 25% in 1995. While in general the share of commodities in total exports is tending to decrease, the increased contribution of manufactures and semi-manufactures reflects a strong bias towards industrial activities based on natural resources processing.

The incorporation of technical progress during the period under review has centred basically on the direct exploitation or industrial processing of natural resources.

## Box III.5

EXPORT DIVERSIFICATION AND STRENGTH IN  
CENTRAL AMERICA

Central American exports to the United States have changed significantly in recent years, showing greater dynamism and an upward trend. For example, Central America's share in total United States imports rose from 0.514% in 1990 to 0.789% in 1995. Over the same period, El Salvador, Honduras and Nicaragua more than doubled their share in such imports. Moreover, traditional exports, such as coffee, fruit and sugar, have generally been displaced by new export products, particularly clothing and accessories. In 1994, such categories (chapters 61 and 62 of the Harmonized Commodity Description and Coding System) constituted 48.82% of total Central American exports. The contribution of these exports (most of which were produced in *maquiladoras*) to total Salvadorian and Honduran exports to the United States in 1994 was 65.43% and 59.3%, respectively.

In this context, the relative unit prices to 10 digits (product price/quantity) of the major export items (particularly clothing) of each of the Central American countries are clearly much lower than the relative unit prices of total United States imports, especially as compared with their major competitors in these categories (China, South Korea, Italy, Hong Kong and Mexico). From 1992 onwards, the total demand for clothing and accessories in the United States market has tended to decline, notwithstanding the growing dynamism of Central American exports of such items. This

tendency towards an increased contribution of these products to total exports, coupled with a decline in the overall demand for them in the United States market, has been widespread since 1994.

The above discussion makes it clear that the Central American economies have made great strides with regard to diversification, competitiveness and linkages with global markets since 1990 (see table III.22). In addition, the subregion's exports have undergone significant structural changes and have been concentrated heavily in clothing and accessories, particularly exports to the United States.

Nevertheless, Central America's obvious specialization in products of this type should be analysed with caution, for the following reasons: i) The overall demand for them is uncertain and shows a strong declining trend; ii) The relative unit prices and added value of these goods are low in the subregion; iii) Exports of these goods depend in large measure on tariff preferences and entry facilities granted by the importing countries which, in most cases, are subject to bilateral negotiations, involving a high degree of uncertainty. Moreover, maquila-type production, which accounts for a major share of such exports, continues to be an insecure method of establishing linkages with global markets, as maquila activities are highly dependent on the decisions of importing countries and transnational corporations, and can thus be shifted quickly to other regions.

Source: R. Buitelaar, "Agenda para la modernización industrial en Centroamérica" (XP/CAM/95/001), document prepared by ECLAC subregional headquarters in Mexico for the Federation of Industrial Chambers and Associations in Central America and for Ministries of Economic Affairs of Central America, December 1995, preliminary version.

Table III.19  
LATIN AMERICA AND THE CARIBBEAN: TRENDS AND VARIATION IN THE  
RELATIVE PRICE INDEX OF LEADING EXPORTS

	Average index (1980 = 100)				Rates of variation (percentages)			
	1975- 1979	1980- 1984	1985- 1989	1990- 1995 <sup>a</sup>	1975- 1979	1980- 1984	1985- 1989	1990- 1995
Raw sugar	58.4	49.6	25.9	31.0	55.8	64.3	33.4	19.5
Bananas	101.8	110.3	113.5	120.6	7.3	8.3	11.6	16.7
Cocoa	145.0	91.1	69.4	38.6	35.5	14.9	33.9	12.7
Coffee (mild)	140.3	98.2	88.2	54.1	39.9	8.1	33.7	42.9
Beef	92.6	96.2	81.0	69.9	17.8	3.6	6.5	10.0
Fish meal	104.4	92.2	72.6	67.4	21.4	11.8	16.1	11.1
Maize	93.1	88.2	58.2	52.6	17.7	12.1	17.2	8.3
Soya beans	122.3	102.1	79.3	66.3	8.3	8.0	12.1	4.0
Wheat	109.3	101.7	74.7	65.5	17.9	2.2	16.8	7.6
Cotton	107.2	95.9	67.1	67.4	16.1	7.6	13.0	21.1
Wool	107.3	90.1	84.9	57.2	11.8	8.0	5.7	18.1
Copper	93.0	80.3	86.5	88.2	9.9	14.9	23.7	14.4
Tin	86.8	88.6	47.4	26.9	20.0	7.5	42.4	6.3
Iron	102.3	97.4	92.2	87.4	8.5	4.4	17.1	9.3
Lead	99.0	71.8	56.5	50.8	30.5	27.3	14.0	22.1
Zinc	135.8	122.6	132.4	119.5	19.3	15.5	26.3	17.1
Crude petroleum	51.3	96.6	49.6	39.8	10.3	7.8	43.4	11.9
Average index	102.9	92.5	75.3	64.4	6.8	6.0	8.1	6.5

Source: ECLAC, on the basis of official figures; and UNCTAD, *Handbook of International Trade and Development Statistics*.

<sup>a</sup> The 1990-1995 average was calculated on the basis of an estimate of 1995 prices. The nominal price indexes were deflated by the unit value export index for developed countries.

Table III.20  
LATIN AMERICA (19 COUNTRIES): RATES OF VARIATION IN EXTERNAL TRADE PRICES  
(Percentages)

	Unit prices of exports				Unit prices of imports			
	1960- 1969	1970- 1979	1980- 1989	1985- 1994	1960- 1969	1970- 1979	1980- 1989	1985- 1994
Argentina	4.8	32.7	13.9	8.0	1.4	9.8	2.3	3.1
Bolivia	21.6	59.3	15.3	13.1	1.1	7.6	2.4	2.5
Brazil	5.1	40.2	9.2	5.1	1.4	11.8	2.7	1.8
Chile	21.8	26.3	14.5	12.5	1.8	11.0	1.8	2.5
Colombia	5.8	49.4	9.8	9.5	0.5	8.4	1.3	1.4
Costa Rica	4.1	40.2	5.8	8.4	0.7	8.2	2.2	1.0
Ecuador	5.0	43.2	23.3	13.5	0.9	10.2	3.9	1.6
El Salvador	3.8	41.7	12.6	15.9	1.3	8.9	2.1	2.1
Guatemala	4.9	37.8	6.9	5.6	3.5	8.7	1.2	0.9
Haiti	7.4	43.4	14.2	10.9	0.7	9.0	1.2	1.5
Honduras	6.6	41.9	5.8	4.3	2.7	10.4	1.4	1.5
Mexico	7.1	38.1	21.7	10.1	2.8	9.7	1.7	2.7
Nicaragua	2.7	32.9	6.8	16.1	2.3	8.2	1.2	2.4
Panama	8.2	31.3	13.2	14.4	0.6	11.6	3.0	3.4
Paraguay	7.2	39.4	11.2	12.1	1.7	10.0	3.8	0.9
Peru	15.3	31.7	11.2	13.5	2.4	10.6	2.0	3.5
Dominican Republic	13.4	36.3	14.4	10.8	0.5	9.0	1.8	3.2
Uruguay	6.8	27.6	10.7	9.0	2.4	13.7	2.1	1.9
Venezuela	8.0	65.4	26.6	20.0	2.9	8.1	2.0	1.1

Source: ECLAC, on the basis of official figures.

Table III.21  
**LATIN AMERICA (16 COUNTRIES): BREAKDOWN OF MERCHANDISE EXPORTS<sup>a</sup>**  
 (Percentages)

		Primary products	Semi-manufactures	Manufactures	Others	Total
Argentina	1970	61.3	25.6	13.1	0.1	100.0
	1980	48.9	30.6	20.5	0.0	100.0
	1994	36.3	33.4	30.3	0.0	100.0
Bolivia	1970	48.4	45.8	5.8	0.1	100.0
	1980	61.3	36.5	2.2	0.0	100.0
	1993	42.6	32.6	15.7	9.1	100.0
Brazil	1970	67.0	21.2	11.5	0.3	100.0
	1980	30.2	36.0	33.6	0.2	100.0
	1994	19.9	30.3	48.0	1.8	100.0
Chile	1970	12.9	84.9	2.2	0.0	100.0
	1980	20.2	74.4	5.3	0.1	100.0
	1994	30.4	56.3	8.9	4.4	100.0
Colombia	1970	85.1	7.7	6.6	0.6	100.0
	1980	70.3	11.3	16.1	2.3	100.0
	1993	51.5	10.6	31.6	6.3	100.0
Costa Rica	1970	72.0	11.9	16.1	0.0	100.0
	1980	60.2	13.7	26.1	0.0	100.0
	1992	55.8	14.1	21.8	8.2	100.0
Ecuador	1970	90.5	7.9	1.6	0.0	100.0
	1980	74.3	23.5	2.2	0.0	100.0
	1992	90.1	6.7	3.0	0.2	100.0
El Salvador	1970	63.2	11.4	25.2	0.2	100.0
	1980	54.2	15.0	30.5	0.3	100.0
	1991	45.5	20.0	34.3	0.1	100.0
Guatemala	1970	60.1	13.5	26.3	0.1	100.0
	1980	60.2	17.6	22.0	0.2	100.0
	1992	47.6	25.3	26.9	0.2	100.0
Honduras	1970	75.0	18.2	6.8	0.0	100.0
	1980	77.8	12.8	9.3	0.0	100.0
	1992	81.1	7.6	10.6	0.7	100.0
Mexico	1970	45.3	26.7	27.7	0.3	100.0
	1980	80.7	9.7	9.5	0.1	100.0
	1992	38.2	13.5	47.6	0.6	100.0
Nicaragua	1970	68.3	18.0	13.7	0.1	100.0
	1980	73.1	15.7	11.2	0.0	100.0
	1991	68.4	21.3	7.2	3.1	100.0
Paraguay	1970	43.7	49.2	7.1	0.0	100.0
	1980	56.7	37.2	6.1	0.0	100.0
	1993	62.1	24.4	13.5	0.0	100.0
Peru	1970	30.5	68.4	1.0	0.0	100.0
	1980	44.9	40.3	14.7	0.1	100.0
	1993	21.1	57.5	14.9	6.5	100.0
Uruguay	1970	61.6	20.9	17.4	0.1	100.0
	1980	39.8	24.5	35.6	0.1	100.0
	1993	28.1	31.2	40.1	0.6	100.0
Venezuela	1970	70.0	29.0	0.7	0.2	100.0
	1980	66.6	32.2	1.1	0.0	100.0
	1993	50.9	37.0	10.8	1.4	100.0

Source: ECLAC, on the basis of official information.

<sup>a</sup> Merchandise exports were classified in accordance with the approach outlined in ECLAC, "El comercio de manufacturas de América Latina: evolución y estructura, 1962-1989", Estudios e informes series, No. 88 (LC/G.1731-P), Santiago, Chile, November 1992, pp. 30-34. United Nations publication, Sales No. S.92.II.G.12.

Table III.2  
CENTRAL AMERICA: INDICATORS OF EXPORT DIVERSIFICATION AND  
PERFORMANCE IN TRADE WITH THE UNITED STATES

Country	Growth of exports of goods and services (1988-1993) <sup>a</sup>	Share in imports (percentages) (1994) <sup>b</sup>	Ranking in key export categories (1991-1995) <sup>c</sup>	Exports of manufactures (percentage of merchandise exports) (1992) <sup>d</sup>	Increases in export market share (1994) <sup>e</sup>	Diversification of exports (1994) <sup>f</sup>
Costa Rica	13.1	0.2	-7.8	25.6	12.7	186
El Salvador	4.4	0.1	11.0	47.8	131.8	102
Guatemala	9.8	0.2	-12.1	29.9	38.6	150
Honduras	0.8	0.2	-9.3	12.9	109.6	110
Nicaragua	7.2	0.0	-107.1	7.0	311.9	26
Panama	13.3	0.0	-13.6	16.7	-18.9	53
Dominican Republic	4.4	0.5	-7.8	49.3	38.9	225

Source: United States Department of Commerce; United Nations Conference on Trade and Development (UNCTAD), *Handbook of International Trade and Development Statistics*, New York; ECLAC, *Statistical Yearbook for Latin America and the Caribbean*, Santiago, Chile; and International Monetary Fund (IMF), *International Financial Statistics*, Washington, D.C.

<sup>a</sup> Average annual rate of growth in the value of exports of goods and services. <sup>b</sup> Share of each country's exports in total United States imports. <sup>c</sup> Change in United States imports of products exported by each country as a proportion of the total change in United States imports of these products 1991-1995 average. <sup>d</sup> Exports of manufactures as a percentage of merchandise exports. <sup>e</sup> Percentage change in the proportion of goods imported by the United States from each country relative to total United States imports of these products. <sup>f</sup> Number of products exported to the United States that have a value of over US\$ 500,000.

Thus, the region has made strides in diversifying and in applying technical progress to its exports. Nevertheless, the share of commodities (foodstuffs, non-food agricultural products, metals and minerals, fuels) in its exports remains higher than the average for the developing countries. While the region's performance is above the world average in terms of the volume of exports, their value is considerably eroded by persistent, steep fluctuations in prices and in the terms of trade. Moreover, the region maintains a trade surplus in commodities, which helps to finance the net deficit in the manufacturing and service sectors. Since world trade reflects a greater demand for products with a higher technological content, particularly manufactures not

based on natural resources, the challenge of competitiveness calls for redoubled efforts to diversify the exportable supply, incorporate technology and increase the quality and depth of the links between exports and other productive sectors.

## 2. Evolution of the region's international competitiveness

The world economy has entered upon a process of transformation marked by ever more intense competition. Such competition plays a growing role in the definition and distribution of benefits to countries, whose international com-

petitiveness can be measured in many ways.<sup>52</sup>

From 1980 to 1993, the contribution of manufactures to the total imports of the Organization for Economic Cooperation and Development (OECD) member countries grew rapidly, from 72% to almost 90%; meanwhile, the developing countries' share in these imports of manufactures rose vigorously, from 11% to 19% of the total. In addition, the contribution of manufactures not based on natural resources<sup>53</sup> increased from 66% to 76% of total imports, while the developing countries' share in such imports grew from just under 8% in 1980 to 18% in 1993. In other words, the process of transformation of the world economy opened up an important channel for participation by the developing countries in the most active segment of international trade.

During this period, the most dynamic growth was concentrated in five industries: computers, other electrical machinery and electronic equipment, clothing, non-electrical machinery and motor vehicles. In 1993, these five groups alone accounted for nearly one third of total OECD imports. Clearly, the countries which achieve linkages with world trade in these categories will link their growth and development to those of the most dynamic segment of international trade. Moreover, the OECD countries' market share in these active categories has fallen, which has given other countries an opportunity to increase their exports of such products to the OECD.

Among developing countries, those which have proved to be the most

competitive are the Asian countries, particularly the "four tigers" (South Korea, Hong Kong, Singapore and Taiwan, Province of China); these countries have geared their export structure to the most dynamic OECD imports (see table III.23). In 1993, manufactures accounted for 92% of their total exports to the OECD; of these, manufactures not based on natural resources accounted for 90%. From 1980 to 1993, the increase in their share in OECD imports (from 3.5% to 5.9% overall) was greater for manufactures (from 5.4% to 7.3%) and, in particular, for manufactures not based on natural resources (from 5.73% to 7.65%).

Moreover, the 10 leading export categories of these four countries include only products with a dynamic external trade profile. This means that the countries in question are conquering markets for more technologically sophisticated goods and losing them for simpler goods, such as clothing and footwear.

Latin America's experience has been different. Table III.23 shows that, while the Latin American countries that are members of the Latin American Integration Association (LAIA) have indeed made the appropriate changes in the structure of their OECD exports (between 1980 and 1993, the contribution of manufactures amply doubled, from 23% to 48%, and that of manufactures not based on natural resources virtually tripled), their share in total OECD imports declined slightly (from 4.4% to 4.1%, and the competitive position of the dynamic sectors registered only limited gains from

52 Among ways of measuring countries' international competitiveness, two extreme examples can be mentioned: *The Economist*, which uses the real effective exchange rate as the sole index of competitiveness, and the World Economic Forum, which included 381 separate criteria in the 1994 edition of its *World Competitiveness Report*. The estimates contained in this document were prepared using a software program developed by ECLAC, Competitiveness Analysis of Nations (CAN), version 2.0. This program defines international competitiveness solely on the basis of each country's share in the imports of the countries members of the Organization for Economic Cooperation and Development (OECD) (Mortimore, 1995).

53 Manufactures not based on natural resources include the products listed in sections 5 to 8 of the United Nations Standard International Trade Classification (SITC, Rev.2), with the exception of divisions 61, 63 and 68 and groups 661, 662, 663, 667 and 671.

Table III.23  
**INTERNATIONAL COMPETITIVENESS OF LATIN AMERICA  
 AND THE CARIBBEAN, 1980 AND 1993**  
 (Percentages)

	LAIA <sup>a</sup>		Central America and the Caribbean <sup>b</sup>		East Asia <sup>c</sup>	
	1980	1993	1980	1993	1980	1993
<b>I. Contribution (structure of exports to OECD)</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
Natural resources (1) + (2) + (3)	75.6	49.2	85.1	54.0	13.1	6.4
Agriculture (1)	30.3	25.2	48.7	41.5	5.8	4.7
Energy (2)	36.1	18.6	22.5	4.9	4.9	1.3
Other natural resources (textile fibres, minerals, etc.) (3)	9.3	5.4	13.9	7.7	0.7	0.4
Manufactures (4) + (5)	23.1	48.1	12.2	43.0	84.7	92.1
Based on natural resources (4)	8.5	7.2	3.2	3.6	4.1	1.7
Not based on natural resources (5)	14.6	40.5	9.0	39.4	80.6	90.4
Other (6)	1.3	2.7	2.7	3.0	2.3	1.5
<b>II. Market share in OECD imports</b>	<b>4.4</b>	<b>4.1</b>	<b>0.9</b>	<b>0.6</b>	<b>3.5</b>	<b>5.9</b>
Natural resources (1) + (2) + (3)	7.6	8.5	1.7	1.3	1.0	1.6
Agriculture (1)	9.3	8.5	3.0	1.9	1.9	2.3
Energy (2)	6.2	8.0	0.8	0.3	0.7	0.8
Other natural resources (textile fibres, minerals, etc.) (3)	11.3	11.5	3.4	2.2	0.7	1.3
Manufactures (4) + (5)	1.9	2.7	0.2	0.3	5.4	7.3
Based on natural resources (4)	6.7	6.6	0.5	0.4	2.5	2.2
Not based on natural resources (5)	1.3	2.4	0.2	0.3	5.7	7.6
Other (6)	3.0	4.2	1.3	0.6	4.2	3.4

Source: ECLAC, using version 2.0 of the CAN (Competitiveness Analysis of Nations) software program.

<sup>a</sup> Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Mexico, Peru, Paraguay, Uruguay and Venezuela. <sup>b</sup> Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, Barbados, Cuba, Dominican Republic, Haiti, Jamaica and Trinidad and Tobago. <sup>c</sup> South Korea, Hong Kong, Singapore and Taiwan, Province of China.

(1) Sections 0, 1 and 4; divisions 21, 22, 23, 24, 25 and 29 of the Standard International Trade Classification (Rev. 2).

(2) Section 3.

(3) Divisions 26, 27 and 28.

(4) Divisions 61, 63 and 68; groups 661, 662, 663, 667 and 671.

(5) Sections 5, 6 (minus the divisions and groups mentioned in 4), 7 and 8.

(6) Section 9.

1980 to 1993 (from 1.9% to 2.7% for manufactures, and from 1.3% to 2.4% for manufactures not based on natural resources) (Mortimore, 1995).

Only three of the leading exports of the LAIA countries represent the most dynamic categories of external trade (passenger vehicles, vehicle parts, and equipment for distributing electricity).

Table III.23 also shows that the Central American and Caribbean countries

concentrate their external trade on natural resources to an even greater extent than the LAIA countries, and that, despite having restructured their OECD exports in favour of manufactures, they have been unable to prevent a decline in their share in total OECD imports (from 0.9% to 0.6%) between 1980 and 1993. The modest increase in the Central American and Caribbean share in manufactures (from 0.2% to 0.3%) could not offset the decline in natural resources (from 1.7% to 1.3%).

The list of the 10 leading exports of this group of countries is dominated by natural resources (fruit, coffee, sugar, petroleum and petroleum products, minerals); nevertheless, there are signs that a new group of competitive products—clothing articles—is emerging. This group accounts for four of the five most dynamic export categories and for all the activities in which these countries are conquering markets.

At least two countries of the region, Mexico and the Dominican Republic, have been relatively successful in utilizing the opportunities offered by the transformation of international trade during 1980-1993 and have markedly improved their competitive positions. Mexico's OECD export structure has been significantly transformed: the contribution of manufactures not based on natural resources has increased from 25% to 68%. In contrast to the experience of other countries in the region, this change has led to a significant gain in Mexico's share in total OECD imports (from 1.3% to 1.8%) and imports of manufactures not based on natural resources (from 0.7% to 1.7%).

Although petroleum remains in first place, with nearly 15% of Mexican exports to the OECD, the rest of the list consists almost entirely of manufactures in the most dynamic categories, such as motor vehicles and electrical machinery and electronic equipment.

The restructuring of OECD exports in favour of manufactures was more pronounced in the case of the Dominican Republic, where such exports increased from 29% to 81% (from 1980 to 1993, manufactures not based on natural resources increased from 15% to 69% of the total). Apart from natural resources

such as nickel and sugar, the Dominican Republic's leading exports stemmed from free zones. The improvement in its competitive position, therefore, is directly linked to these zones and to the transnational corporations, mainly of United States origin, which have made efforts to increase their competitiveness in light industries (clothing and electronic equipment) through in-bond assembly (*maquila*) operations, combined with special access to the United States market. Nevertheless, these operations do not appear to have contributed a great deal in terms of technology transfers (Mortimore, Duthoo and Guerrero, 1995).

In conclusion, the competitive position of Latin America and the Caribbean lags clearly behind that of the Asian developing countries or the four Asian "tigers". While the Latin American and Caribbean export structure has changed significantly in favour of manufactures that are more in demand, the region's share in OECD imports, especially in the more dynamic categories, has made very limited gains.

The more notable exceptions to this picture have been the relative successes of the Mexican motor vehicle industry and of the free zones (*maquiladoras*) of Mexico and the Dominican Republic. In both cases, transnational corporations have played a very important role. The figures show that Latin America and the Asian developing countries have pursued international competitiveness along very different paths and that, if access to the dynamic OECD import markets is a good indicator, the region faces the need to catch up in the area of exports with a higher technological content, which constitute the most dynamic import categories in that megamarket.



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- 10 *Políticas sociales: resúmenes de documentos*, 1995, 95 pp.
- 11 *Modernización del Estado: resúmenes de documentos*, 1995, 73 pp.

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