ECONOMIC COMMISSION FOR LATIN AMERICA
AND THE CARIBBEAN

ECONOMIC SURVEY OF LATIN AMERICA AND THE CARIBBEAN 1994-1995

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THE REGION

Notes and explanation of symbols

The following symbols have been used in the tables in this Survey:

Three dots (...) indicate that data are not available or are not separately reported.
A dash (-) indicates that the amount is nil or negligible.
A blank space in a table means that the item in question is not applicable.
A minus sign (-) indicates a deficit or decrease, unless otherwise indicated.
A full stop (.) is used to indicate decimals.
A slash (/) indicates a crop year or fiscal year, e.g., 1969/1979.
Use of a hyphen (-) between years, e.g., 1960-1970, signifies an annual average for the calendí r years involved, including the beginning and the end years.
References to "tons" mean metric tons, and to "dollars" United States dollars, unless otherwise slated.
Unless otherwise stated, references to annual growth rates of variation mean cumulative annual r ites.
Figures and percentages in tables may not neccessarily add up to the corresponding totals, because of rounding.

FOREWORD

This issue of the Economic Survey of Latin America and the Caribbean differs in some important respects from previous years. In addition to a detailed analysis of the trends in the region's economies in 1994, it also covers economic developments in the early months of 1995. The aim was to provide continuity by following economic events up to the moment of writing in so far as information was available.

- The Survey is appearing in a single volume comprising both a regi inal analysis and reports on each country. In the new format the Survey is shorter, since some of the country-specific information formerly included in the regional chapters is now given only in the country reports.
- The regional section has been restructured. The chapter on economic policy also covers public finances and monetary and foreign exchange policy and includes two new sections on structural reform and the integration process.
- The format of the country reports remains the same; they discuss economic policy in greater detail and outline the results achieved. The statistical information accompanying each report is limited to two tables and one figure summarizing trends in the main variables.
- More detailed statistical information on each country from 1987 to the present will be presented in an annex, available on diskette, to be distributed separately.

Further improvements will be made in the Survey next year. It is anticipated, for example, that the base year for figures at constant prices will be changed to 1990.

I. MAES TRENDS

During most of 1994, there were further signs of consolidation of a more dynamic economic picture in Latin America and the Caribbean, with faster growth and a substantial reduction in the rate of inflation. With the explosion of the foreign exchange crisis on 20 December in Mexico -where pressure had gradually been building since the early months of the year due to a combination of serious political factors and the accentuation of imbalances already manifest in previous years- the region once again braced for turbulence, and fears were rife that the crisis would spread throughout the region in a repeat of the 1982 crisis.

The impact of the Mexican crisis was, in fact, felt immediately in other countries of the region and reflected in a significant decline in international reserves, falling prices on the stock exchanges and liquidity problem:; in the banking systems. In Argentina, in particular, fears revived that the currency would have to be devalued and that the stabilization process initiated in 1991 would be cut short, while in Brazil the impact threw new obstacles in the way of the stabilization programme that had just got under way. In other countries, the impact was less dramatic, but their Governments were forced to tread warily in the new situation.

The crisis deepened during the first quarter of 1995, but later eased off in response to the adjustment measures adopted b) the countries most heavily affected, strong support from the developed countries and international organizations and the recovery in the economies of the industrialized countries, which was reflected in higher prices for basic products.

1. **The economy of Latin America and the Caribbean in 1994**

Overall, in 1994, the economies of Latin America and the Caribbean turned in a stronger performance than in previous years. The growth rate of gross domestic product for the region progressed from an annual average of 3.3% for the three-year period 1991-1993 to 4.5% in 1994, the highest figure since 1980; per capita GDP rose 2.7% as a result. Average inflation (excluding Brazil) dropped to 16%, its lowest point in several decades. The countries of the region continued to attract large amounts of foreign capital, some US$ 43.5 billion in 1994, which helped to finance the growing current account deficit. Flows were lower than in the two previous years, however, because of problems in some countries in the region, which experienced a significant drop in capital inflows. Venezuela in particular posted a negative balance on its capital account after three years of positive balances. Mexico also experienced a major reduction in c apitai inflows, perceptible even in the early months of 1994, accentuated towards the end of the year and culminating in a sharp devaluation of the currency.

In spite of the climate of uncertainty in a number of countries due to the ele :toral process, the improvement in the region's economic performance was facilitated by su: tained growth in internal investment and adherence to the policies of stabilization and structural reform adopted in earlier years. These measures were responsible for a gradual improvement in the underlying structure of the economies, despite their negative effects on some sectors over the short term. Economic performaice was also heavily influenced by the upturn in the world economy, particularly during the second half

Table I-1
LATIN AMERICA AND THE CARIBBEAN: MAIN ECONOMIC INDICATORS

	1987	1988	1989	1990	1991	1992	1993	1994[b]
	Indexes (1980=100)							
Gross domestic product at market prices	110.3	111.2	112.1	112.5	116.5	120.1	123.9	129.5
Gross national income	104.6	104.9	105.3	106.2	110.0	113.7	116.5	122.6
Population (millions of inhabitants)	399.3	407.1	415.0	422.9	430.7	438.8	446.9	455.0
Per capita gross domestic product	95.3	94.2	93.2	91.8	93.3	94.4	95.6	98.2
Per capita gross national income	90.2	88.8	87.4	86.5	87.9	89.1	89.7	92.7
	Ratios (percentages)							
Urban unemployment rate[0]	5.7	5.8	5.4	5.8	5.8	6.2	6.2	6.4
	Annual growth rates							
Gross domestic product	3.3	0.8	0.9	0.3	3.6	3.0	3.2	4.5
Per capita gross domestic product	1.2	-1.1	-1.0	-1.5	1.7	1.1	1.3	2.7
Per capita gross national income	1.9	-1.6	-1.6	-1.0	1.6	1.4	0.7	3.3
Consumer prices	209.2	776.8	1212.5	1191.3	199.7	418.9	887.6	342.4
Current value of exports of goods and services	13.6	14.0	11.0	10.3	0.6	6.9	6.0	14.5
Current value of imports of goods and services	10.2	14.0	7.2	13.5	15.5	21.3	8.8	14.9
Terms of trade (goods and services)	0.8	0.4	-0.1	-0.1	-3.8	-0.8	-0.7	2.8
	Billions of dollars							
External sector								
Trade balance (goods and services)	17.2	19.6	25.5	23.8	4.9	-14.6	-20.4	-24.3
Net payments of profits and interest	31.2	34.6	38.6	34.2	31.4	31.1	33.0	34.2
Balance on current account	-10.6	-11.2	-8.8	-4.2	-18.8	-36.9	-45.9	-48.9
Balance on capital account	14.9	5.4	12.0	18.3	37.9	61.6	66.8	43.5
Balance-of-payments position	4.3	-5.7	3.2	14.2	19.2	24.7	20.8	-5.4
Total disbursed external debt	427.7	419.7	424.9	442.7	457.5	474.8	506.7	533.3

Source: ECLAC, on the basis of official figures.
* The figures given for the gross domestic product and the population correspond to the countries appearing in table 1-2 (except Cuba), while those given for consumer prices refer to the countries listed in table 1-4. The data concerning gi oss national income and the external sector (except for the figures on external debt) correspond to the countries shown in table IV-20. The figures for external debt refer to the countries listed in table IV-10. Preliminary figures. Weighted annual rate for the population of 17 countries in Latin America. [d] December-tc-December variation.

of the year, a recovery that produced significant growth in international demand and an increase in prices of basic products after several years of declining trends. The impact of the recovery was countered to some extent by higher international interest rates, although their effect on the region was limited, since, before the increase, interest rates had been at the lowest levels in over 30 years. A further impetus was provided by renewed regional integration efforts.

Notwithstanding the improvement in the economy, job creation continued to be inadequate in much of the region, as the work force grew at a faster pace, driven by higher rates of participation. In some countries, economic restructuring and efforts to improve competitiveness had negative short-term effects on labour demand. As a result, unemployment and underemployment did not decline in step with the increase in growth rates, and in some countries they actually increased despite the stimulus of expanded output.

In general, it was evident that in Latin America and the Caribbean growth rates of around 4% were not enough to allow for major progress in the fight against poverty or to prevent unemployment and underemployment from reaching unacceptable levels. Furthermore, capital inflows, while welcome for their contribution to growth and investment, reflected the inadequacy of internal saving and might undermine efforts to expand exports. There remained much to be done, therefore, in order to increase international competitiveness while at the same time improving social equity in years to come.

Price stability remained a high priority in economic policy, and there was further progress in this area. Most of the countries had inflation rates of under 25% in 1994. Only Brazil, Ecuador, Haiti, Honduras, Jamaica, Uruguay and Venezuela exceeded that level. Seven countries -Argentina, Bolivia, Chile, El Salvador, Mexico, Panama and Trinidad and Tobago- actually achieved single-digit inflation, while Barbados registered a slight decrease in the price index. The most spectacular instance of stabilization in 1994 was that of Brazil, where the Real Plan reduced the monthly rate of inflation from nearly 50% to around 3%. Major progress was also made in Peru, where rates declined from over 7,500% in 1990 to 15% in 1994. Argentina achieved a similar success, reducing inflation from 4,900% in 1989 to only 3.7% in 1994. A number of countries, however, experienced setbacks in this area in 1994, notably Costa Rica, Honduras, the Dominican Republic and Venezuela, which had much higher inflation rates than in 1993.

In previous years, progress or setback in the fight against inflation had depended in large measure on the fiscal situation, which in most of the countries of the region was kept under control or financed with external resources. In 1994, however, it was observable that the adjustments were far more precarious, so that a number of countries were forced to tighten their fiscal austerity policies even further; this was the case with Costa Rica, Honduras, the Dominican Republic and Venezuela. As the year progressed, more countries, including Argenti na, Mexico and Uruguay, began to develop imbilances in their public sector accounts, and Brazi I was unable to achieve a sustainable fiscal adjustment.

Appreciation of local currencies and greater real demand for money were major factors in consolidating price stability in some countries. In others, entrenched indexation mechanisms acted as a drag on anti-inflationary monetary measures.

Against this background, fixed capital investment continued to expand jit the fast pace observable over the past three years. The expansion of investment caused imports of capital goods to grow with particular rapidity in Peru, Argentina and Brazil and to maintain their strong rate of growth in Colombia and Mexico. This was a significant indicator oí the efforts the countries in the region were making to modernize their production structures.

The recovery of the industrialized economies and the resulting expansion of inte mational trade combined with the dynamism ol' intraregional trade created a favourable clirrate for Latin American and Caribbean exports The region's exports in 1994 totalled US$ L54.8 billion, representing an increase ol over 15%, considerably higher than the 5% increases posted in the two previous years. The acceleration was attributable to a shift in the trend o "export prices combined with continued momentum in the volume of sales. The trend shift was chiefly due to the behaviour of prices of basic products, which, excluding fuel prices, rose for the first time since 1989. The value of exports registered a particularly large increase in Bolivia (39%), Peru (30%), Nicaragua (29%), Chile (25%), the Dominican Republic (25%) and Ecuador (21%).

The region's imports in 1994 totalled US$ 175.4 billion, 17% higher than the year before, when they rose 9%. The increase; would have been even larger had it not been for he sharp drop in Venezuelan imports due to recession and limits on the availability of foreign currency. The largest increases in the value of imports occurred in Peru (39%), Brazil (29%), Argentina (28%), Uruguay (22%) and Colombia (20%). These rates reflect a larger volume of purchases, since prices rose only moderately (4%).

The widening deficit in the mere handise trade balance (from US$ 15.7 billion to US$ 20.5

Table 1-2

LATIN AMERICA AND THE CARIBBEAN: GROWTH OF TOTAL GROSS DOMESTIC PRODUCT

(Annual growth rates)

	1988	1989	1990	1991	1992	1993	1994[a]	Cumulative variation 1981-1990	Cumulative variation 1991-1994[a]
Latin America and the Caribbean	**0.8**	**0.9**	**0.3**	**3.6**	**3.0**	**3.2**	**4.5**	**12.5**	**15.1**
South America	**0.7**	-0.1	-1.1	**3.6**	**3.0**	**4.2**	**5.0**	**10.9**	**16.8**
Argentina	•2.1	-6.2	-0.1	8.9	8.7	6.0	6.9	-8.7	34.1
Bolivia	3.0	3.5	4.7	5.1	1.2	4.1	4.2	1.4	15.4
Brazil	•0.1	3.1	-4.4	0.3	-0.8	4.1	5.7	16.8	9.5
Chile	7.0	9.7	3.3	6.8	10.6	5.9	4.1	32.1	30.3
Colombia	4.2	3.5	4.0	1.8	3.8	4.9	5.6	43.6	17.0
Ecuador	8.8	0.2	2.0	4.9	3.4	2.2	4.2	20.4	15.5
Guyana	•2.3	-4.8	-2.7	5.8	7.4	8.0	8.5	-22.4	33.2
Paraguay	6.7	5.9	3.1	2.3	1.7	3.9	3.5	36.6	11.9
Peru	•8.4	-11.5	-5.6	2.6	-2.3	6.5	12.7	-11.4	20.3
Suriname	7.8	4.2	0.1	3.5	5.8	-4.5	-0.8	4.8	3.7
Uruguay	0.0	1.3	0.9	3.2	7.9	2.5	5.1	4.7	20.0
Venezuela	5.9	-7.8	6.8	9.7	5.8	-0.2	-2.9	4.2	12.5
Mexico	**1.2**	**3.3**	**4.4**	**3.6**	**2.8**	**0.6**	**3.5**	**17.9**	**10.9**
Central America and the Caribbean	-0.1	**3.1**	**1.5**	**2.1**	**4.0**	**3.0**	**3.2**	**10.4**	**13.3**
Bahamas	2.3	2.0	4.8	-3.2	1.0	2.4		31.2	0.1[e]
Barbados	3.6	3.7	-3.2	-4.2	-5.9	0.8	4.0	9.5	-5.4
Belize	6.3	13.2	10.3	3.0	11.3	3.6	1.6	56.0	20.7
Costa Rica	3.2	5.5	3.4	2.1	7.3	6.1	4.3	25.1	21.2
Cuba[c]	2.2	0.8	-3.1	-25.0	-14.0	-10.0		37.6	-42.0[e]
El Salvador	1.4	0.2	5.8	3.2	7.0	6.2	4.4	-5.3	22.5
Guatemala	4.0	3.7	2.9	3.5	4.9	3.8	3.8	8.8	16.9
Haiti	0.9	1.0	-0.2	-0.8	-14.3	-5.1	-12.2	-3.8	-29.1
Honduras	4.9	4.7	-0.4	2.3	6.1	6.5	-1.6	25.5	13.8
Jamaica	2.3	6.3	6.2	1.2	2.0	1.6	2.5	31.8	7.5
Nicaragua	12.4	-1.7	0.0	-0.2	0.4	-0.4	3.2	-12.7	3.0
Panama	15.9	-0.2	5.2	9.2	8.4	5.6	4.3	6.3	30.4
Dominican Republic	2.3	4.8	-5.3	0.5	6.8	2.3	4.3	27.5	14.6
Trinidad and Tobago	-3.1	-0.4	1.9	1.7	-2.3	-3.0	4.4	-19.9	0.7
OECS countries[d]	8.3	6.1	4.7	3.3	3.8	2.1	2.9	78.7	12.7

Source: ECLAC, on the basis of official figures converted into dollars at constant 1980 prices.
* Preliminary estimates subject to revision. Excludes Cuba. [c] Refers to total social product.
[d] OECS = Organization of Eastern Caribbean States. Includes Antigua and Barbuda, Dominica, Grenada, Saint Kitts and Nevis, Saint Lucia and Saint Vincent and the Grenadines. [e] Refers to the period 1991-1993.

Table 1-3

LATIN AMERICA AND THE CARIBBEAN: GROWTH OF PER CAPITA GROSS DOMESTIC PRODUCT

(Annual growth rates)

	1988	1989	1990	1991	1992	1993	1994[a]	Cumulative variation	
								1981-1990	1991-1994[a]
Latin America and the Caribbean	-1.1	-1.0	-1.5	**1.7**	**1.1**	1.3	2.7	-8.2	7.0
South America	-1.2	-1.9	-2.9	1.8	1.2	2.4	3.2	-9.2	8.8
Argentina	-3.5	-7.5	-1.4	7.5	7.3	4.8	5.6	-21.2	27.7
Bolivia	0.7	1.3	2.4	2.7	-1.2	1.6	1.7	-17.4	4.8
Brazil	-2.0	1.2	-6.1	-1.5	-2.5	2.4	3.9	-4.6	2.2
Chile	5.2	7.8	1.6	5.0	8.8	4.2	2.4	12.4	21.9
Colombia	2.3	1.7	2.2	0.1	2.0	3.2	3.9	17.9	9.4
Ecuador	6.2	-2.2	-0.3	2.5	1.1	-	2.0	-6.6	5.6
Guyana	-2.4	-4.8	-2.8	5.4	6.4	7.0	7.5	-25.8	28.9
Paraguay	3.4	2.7	0.1	-0.6	-1.1	1.1	0.7	-0.8	-
Peru	-10.2	-13.2	-7.5	0.6	-4.1	4.4	10.6	-28.9	11.3
Suriname	6.5	3.3	-1.4	2.3	4.6	-5.6	-1.9	-7.0	-0.8
Uruguay	-0.6	0.7	0.3	2.6	7.2	1.9	4.5	-1.4	17.2
Venezuela	3.1	-10.2	4.2	7.1	3.4	-2.4	-5.1	-19.4	2.6
Mexico	-0.7	1.4	2.5	**1.7**	0.9	-1.2	**1.7**	-4.3	3.1
Central America and the Caribbean	-2.3	0.7	-0.8	0.3	1.5	0.5	0.7	**-11.7**	3.5
Bahamas	0.5	1.1	2.0	-4.8	-0.7	0.7		7.7	-4.7[e]
Barbados	3.2	2.8	-3.0	-4.5	-6.2	0.4	3.6	6.1	-6.8
Belize	3.6	12.2	5.6	0.4	8.5	1.0	-1.0	20.5	8.8
Costa Rica	0.4	2.6	0.7	-0.4	4.6	3.5	1.9	-5.8	9.9
Cuba[c]	1.2	-0.2	-4.0	-25.7	-14.7	-10.7		-4.0	-43.4[e]
El Salvador	-0.4	-1.7	3.7	1.1	4.7	3.9	2.1	-17.1	12.3
Guatemala	1.0	0.8	-	0.6	1.9	0.8	0.9	-18.2	4.2
Haiti	-1.1	-1.0	-2.2	-2.8	-16.0	-7.0	-14.0	-20.6	-34.7
Honduras	1.7	1.6	-3.4	-0.7	3.0	3.4	-4.5	-8.2	1.1
Jamaica	1.9	5.4	6.1	12.3	0.5	-0.1	0.7	18.9	13.5
Nicaragua	-14.5	-4.3	-3.0	-3.6	-3.4	-4.3	-0.7	-33.5	-11.5
Panama	-17.6	-2.2	3.1	7.2	6.4	3.6	2.4	-13.6	21.0
Dominican Republic	0.1	2.5	-7.2	-1.5	4.7	0.4	2.4	2.1	6.1
Trinidad and Tobago	-4.3	-1.2	0.2	0.6	-3.4	-4.0	3.3	-29.9	-3.7
OECS countries[d]	7.9	5.2	4.3	2.7	3.0	1.7	1.9	70.2	9.7

Source: ECLAC, on the basis of official figures converted into dollars at constant 1980 prices.

* Preliminary estimates subject to revision. Excludes Cuba. [c]Refers to total social product. OE ^S = Organization of Eastern Caribbean States. Includes Antigua and Barbuda, Dominica, Grenada, Saint Kitts and Nevis, Sail it Lucia and Saint Vincent and the Grenadines. [e] Refers to the period 1991-1993.

billion) was a factor in perpetuating the tendency towards a growing current account deficit financed by massive capital inflows. The current account deficit rose from US$ 46 billion in 1993 to US$ 49 billion in 1994. Mexico (US$ 29.2 billion) and Argentina (US$ 10.1 billion) ran the largest deficits, in both cases higher than in 1993. Brazil, Colombia and Peru also posted significant deficit increases of between US$ 500 and US$ 800 million. Other countries ran deficits fairly similar to those of the year before, two exceptions being Chile (where the deficit narrowed because of the strong performance of exports) and Venezuela (where the balance shifted from deficit to surplus thanks primarily to a marked drop in imports).

Capital inflows to finance the current account deficit were again plentiful, totalling some US$ 43.3 billion. While this amount was lower than the US$ 67 billion that came into the region the year before, capital flows remained strong despite potential disincentives such as the uncertainties created by a number of crucial electoral contests, the problems confronting the financial systems of some countries and the rise in interest rates in the United States. It should be added, moreover, that the only major episodes of capital flight occurred close to the end of 1994 in Mexico and Venezuela and did not have repercussions on other countries. Since net capital inflows for the region as a whole were less than the current account deficit, international reserves decreased by US$ 5.6 billion, compared with an average accumulation of over US$ 20 billion per year during the three-year period 1991-1993.

The sharpest drop in capital flows was experienced in Mexico, where fears of political instability led investors to reduce their net investments of US$ 30.7 billion to US$ 10.3 billion, still a fairly large amount, equal to nearly one fourth of net flows into the region as a whole. Since the sum was considerably lower than the Mexican current account deficit, international reserves declined US$ 18.9 billion to make up the difference. In Venezuela, a banking crisis resulted in a capital outflow of US$ 4.9 billion, in contrast to the inflow of US$ 2.2 billion in 1993. Venezuela was then also forced to draw on US$ 800 millions its reserves, despite the significant turnaround in its curre at account from a serious deficit to a large surplus. A number of Central American and Caribbean countries (Costa Rica, Guatemala and most notably the Dominican Republic) also reteived far less foreign capital than the year befo re. On the other hand, 10 countries received larger capital flows, with Chile, Colombia and Peru posting substantial increases. For the region as a whole, net transfers of funds (net capital flows less interest and dividend payments) :ontinued to be positive for the fourth consecutivo year, although the figure declined from US$ 33.7 billion in 1993 to US$ 9.2 billion in 1994. This was primarily due to the large negative net transfers from Venezuela and Mexico reflect: ng net capital outflows and to the regularizai ion of Brazil's debt service arrears, for which it drew on its international reserves.

Capital flowed into Latin Anerica and the Caribbean in 1994 chiefly in the form of bonds, foreign direct investment and stock purchases through the region's stock exchanges or stock exchanges outside the region in the form of American Depositary Receipts (ADRS) in the United States market and Gloriai Depositary Receipts (GDRS) in the world market. Of the net capital influx of US$ 43.3 billion in 1994, some US$ 17 billion were attracted liy bond issues, even though bonds declined in relative importance compared to 1993. <DRs and GDRs accounted for close to US$ 5 billion, while foreign direct investment brought in some US$ 18 billion. The remainder came from stock purchases through local stock exchanges, official loans and various short-term capital instruments.

The region increased its indebl edness by 5.8% in 1994 to US$ 534 billion. The net increase of nearly US$ 30 billion was largely due to the bond issues mentioned above, togetier with loans from international and regional financial institutions and from Governments of industrialized countries. These increases in liabilities were partially offset by reductions in commercial debt in Brazil, Ecuador and the Dominican Republic, where Bridy plans were implemented.

The combination of a moderate increase in debt and larger increases in exports brought

Table 1-4
LATIN AMERICA AND THE CARIBBEAN: CONSUMER PRICES
(Variations from December to December)

	1988	1989	1990	1991	1992	1993	1944	1995 (Ua June)	
								Y;ar to iate	Last 12 months
Latin America and the Caribbean	**776.8**	**1 212.6**	**1191.7**	**199.7**	**419.0**	**887.6**	**337.1**	**...**	**...**
Argentina	387.7	4 923.3	1 343.9	84.0	17.6	7.7	3.7	1.1	3.7
Barbados	4.4	6.6	3.4	8.1	3.4	-1.0	-0.6		
Bolivia	21.5	16.6	18.0	14.5	10.5	9.4	8.5	5.1	10.9
Brazil	993.3	1 863.6	1 584.6	475.8	1 149.1	2 489.1	929.3	.1.3	33.4
Chile	12.7	21.4	27.3	18.7	12.7	12.2	8.9	3.8	7.6
Colombia	28.2	26.1	32.4	26.8	25.2	22.6	22.5	.3.8	21.6
Costa Rica	25.3	10.0	27.3	25.3	17.0	9.0	19.9	9.8	22.5
Ecuador	85.7	54.3	49.5	49.0	60.2	31.0	25.4	2.5	22.5
El Salvador	18.2	23.5	18.3	9.8	20.0	12.3	8.9	4.4[a]	9.2
Guatemala	12.3	20.2	59.6	10.2	14.2	11.6	11.6	2.9	8.1
Haiti	8.6	10.9	26.1	6.6	18.0	39.3	52.1		
Honduras	6.6	11.4	35.2	21.4	6.5	13.0	28.8	15.3	29.2
Jamaica	8.9	17.2	29.8	80.2	40.2	30.1	32.6		
Mexico	51.7	19.7	29.9	18.8	11.9	8.0	7.1	••2.9	37.7
Nicaragua	33 547.6	1 689.1	13 490.5	775.4	3.6	19.5	12.4	4.5	11.2
Panama	0.3	-0.2	0.8	1.1	1.7	0.9	1.4	•0.1[a]	1.0
Paraguay	16.9	28.5	44.1	11.8	17.8	20.4	18.3	7.1	14.8
Peru	1 722.6	2 775.3	7 649.6	139.2	56.7	39.5	15.3	5.6	11.1
Dominican Republic	57.6	41.2	100.7	4.0	5.2	2.7	14.3	...	
Trinidad and Tobago	12.1	9.3	9.5	2.4	8.5	13.5	5.5		
Uruguay	69.0	89.2	128.9	81.3	59.0	52.9	44.1	18.6	45.0
Venezuela	35.5	81.0	36.5	31.0	31.9	45.9	70.8	22.1	61.2

Source: ECLAC, on the basis of official figures.
[a] To May.

about a reduction in the debt/export ratio for the region as a whole from 302% in 1993 to 280% in 1994, its lowest level since the start of the debt crisis. All the countries of Latin America and the Caribbean, except for Paraguay and Haiti, managed to improve their debt/export ratio, even though in some cases (notably Nicaragua and Haiti), the debt burden continued t< t be quite high and will have to be dealt with in the years to come.

2. **The crisis of late 1994 - early 1995**

The economic crisis that erupted in late 1994 appeared to be similar to that of 1982 and difficult to limit to a single country. This was true, in particular, because it had begun in one of the largest economies in the region, which was also the main recipient of financial resources from abroad. However, some external and internal factors were different from those seen in the 1982 crisis. Rows were not of the same type; in 1982, credit from international commercial banks had predominated, while in 1994 foreign direct investment or portfolio investment (bonds and shares) and repatriation of capital hi >ld sway, with a parallel decrease in the amounts < if commercial bank loans. Moreover, international economic conditions were different; there was no strong dollar, as in 1982, and the economies of the developed countries were expanding, not in recession as they had been earlier. Accordingly, prices of basic products were high, and interest rates, while rising, were lower than in 1982. Meanwhile, the Latin American economies were in a far better position to cope with the crisis than they had been at the start of the 1980s, as there was greater awareness of the need to maintain macroeconomic equilibria. In addition, broad structural reforms had taken place, which improved the countries' linkages with the global economy.

Thus, while the situation in the region has shown some difficulties in the first months of 1995, under no circumstances has there been a widespread crisis. In addition, there are significant differences between countries.

The Mexican crisis continued to deepen in the early months of 1995, forcing the authorities to implement a harsh fiscal adjustment plan aimed at achieving a substantial fiscal surplus; this enabled them to mobilize massive financial resources from abroad, thanks to the decisive support of the United States Government and international institutions. From April onward it was possible to stabilize the exchange rate, which had been floating since the end of December 1994, at around 6 pesos to the dollar, after it had reached nearly 8 pesos. As a result of such measures and of the devaluation itself, the level of activity contracted, while the inflation rate rose to 33% in the first half of 1995 compared to only 7% during 1994. On the other hand, a very favourable trend was seen in the trade balance, which had a surplus of nearly US$ 1.2 billion in the first four months; this contrasts with the deficit of US$ 5.7 billion, equivalent to 6% of GDP, registered in the same quarter of 1994.

In Argentina, the first months of 1995 brought a notable reduction in capital inflows, which caused strong pressure on the foreign exchange market and significant declines in international reserves. The financial system was also seriously affected by the growing fears that a number of banking institutions were in dire straits. Meanwhile, the fiscal problems were aggravated by the drop in tax revenue. In order to cope with the first-mentioned difficulties, tie Government reaffirmed its commitment to maintaining peso convertibility, for which it drew on a large build-up of reserves.

Subsequently, a fiscal adjustment plan was adopted to increase fiscal revenue, especially by raising the value-added tax rati: by 3%, and reduce public expenditure, mainly through wage cuts, and thus achieve a significant surplus in public accounts, which would seive to establish an emergency fund to aid struggling banks. Support from international institutions and contributions from the domestic private sector and international commercial banks were also obtained for this fund. Inflation continued to be very low, while the level of activity showed signs of going into recession. Meanwhile, the trade balance was in surplus during the first five months of 1995, following the high deficit of 1994.

Brazil, too, was affected by the drop in capital inflows, just when it was on the way to consolidating its stabilization process. That was reflected by instability in the forïign-exchange and stock markets and declines in reserves, which, however, remained high. The strong appreciation of the real in the second half of 1994 had undermined the trade balance, which from November onward registered deficits. Thus, the Government faced a dilenma in it's exchange-rate policy. On the on 5 hand, it was difficult to maintain the exchange rate "anchor", which had helped to reduce inflatk in; on the other hand, allowing the real to deprecate would help the trade problem, but would nake it more difficult to control inflation und eliminate indexation.

This dilemma has been expressed in continual changes in exchange-rate policy which have increased economic instability. Added to this were the difficulties of fiscal adjustment and the severity of monetary policy, which had become the main instrument of stabilization. Furthermore, legislative approval of the structural reform process is progressing slowly, although it took important leaps in June. The level of activity remained high in lhe first quarter of 1995, but began to decline theieafter because of the restrictions imposed in ore er to limit the growth of consumption, especially extremely high real interest rates. Meanwhile, in June 1995 the annual inflation rate was around 34%, its lowest level since 1976.

In Chile the Mexican crisis had a lesser impact; this was because the Chilean economy was well tuned, had a fiscal surplus and was registering domestic saving levels far above those of other countries in the region, and because it had a very dynamic export sector which was also favoured by high prices for the main export items. The impact of the crisis was felt, however fleetingly, on the stock exchange. Large capital inflows resumed, so that the Chilean currency was again overvalued.

In the other countries in the rej;ion the effects of the crisis have generally teen of lesser magnitude. In any case, here, too, it was necessary to promote adjustmsnts of some significance. Moreover, the crises of some countries, such as Costa Rica, Honduras and Venezuela, began earlier and were due to specific causes in each case. In 1995 the indicators for these three countries have continued to show setbacks in the level of activity, n slowdown or drop in output, exacerbated inflationary tendencies and a deepening diseqt ilibrium in the balance of payments, along with losses in reserves and even delays in paying debt service.

II. ECONOMIC POLICY

In 1994 the focus of economic policy in the Latin American and Caribbean countries continued to be on maintaining macroeconomic equilibria, since a recurrence of the serious situations encountered some years earlier remained a distinct possibility. In some countries, old problems did in fact recur or persist and required greater attention. At the same time, countries continued to place emphasis on structural reform policies, in part to help achieve macroeconomic equilibria and in part to strengthen the new operating bases of their respective economies. The momentum of structural reform manifest in the early years of the 1990s did slow somewhat, however. Although major ac vanees were announced for 1995 and following years, in Brazil, for instance, the measures were still in the study phase or in debate in the legislature.

A. MACROECONOMIC POLICY

Controlling inflation continued to be the prime goal of macroeconomic policy in most Latin American and Caribbean countries, which in general adhered in broad outline to the policies they had pursued in previous years. More thorough-going fiscal adjustment was one of the chief reasons for in the progress achieved in stabilization programmes, other contributing factors being prudent monetary policy and close monitoring of exchange rates to maintain levels compatible with anti-inflationary targets. These practices went hand in hand with further liberalization of the external sector, particularly through regional agreements aimed at eliminating tariffs between trading partners.

Abundant external capital continued to flow into the region, helping to finance increased domestic demand but lowering real exchange rates. In an environment of primarily floating exchange rate systems, the capital influx generally tended to appreciate national currencies, although some countries set minimum rates to protect external competitiveness. Heavy flows of foreign capital also made it harder to manage monetary policy, leading some countries to adopt measures to restrict the entry of financial resources, particularly short-term capital. In this scenario of abundant foreign resources, however, economic policy-makers often took advantage of the anti-inflationary effect of exchange rate appreciation. Programmes of tarif! reduction and foreign trade liberalization also helped to slow inflation by contributing to an expansion of aggregate supply through an increase in imports costing less than domestic produc s.

In 1994, Brazil, with the region's largest economy, joined the ranks of countries with a stabilization programme by introducing a set of measures that drastically curtailed price increases. In Costa Rica, Honduras and Venezuela, in contrast, signifcant macro-economic disequilibria developed ¡ ind fuelled the pace of inflation. Haiti's situetion became desperate, as the trade blockade and the suspension of international aid persisted nearly to the end of the year. The Mexican economy suffered a new wave of inflation following the devaluation at the end of Decern >er 1994; the jump in prices in the first half of 1995 was the highest since 1989.

In 1994, the public sector in most countries of Latin America and the Caribbean achieved something close to a balanced budget, consolidating the major strides made since 1991, and while the number of deteriorating government budgets increased, the sums involved remained within bounds. To a great extent, these results were the fruit of fiscal adjustment processes initiated in earlier years and the widespread adoption of budget control measures.

Progress in fiscal reform, more realistic pricing policies adopted by public sector enterprises, perseverance in efforts to crack down on tax evasion and proceeds from privatization continued to boost real revenues. Expenditure, particularly capital expenditure, was held in check. These factors helped to keep fiscal results for most countries within acceptable limits in 1994, so that pressure on domestic credit was avoided. Exceptions to this rule were Costa Rica, Venezuela, Haiti and the Dominican Republic, where growing fiscal deficits financed by monetary expansion fuelled higher inflation.

Except in a few cases, then, rronetary policy was facilitated by fiscal managerient and by an increase in the demand for money in a climate of expectations of declining inflation. Hence, most of the challenges that arose in mai itaining a level of monetary expansion compatible with growth and inflation targets had to do with the influx of external capital.

1. **Stabilization plans**

By the beginning of 1994, most of the region's economies had already achieved significant reductions in the rate of inflation. Some of them (Argentina, Bolivia and Peru) once faced situations of near hyperinflation that forced them to undertake drastic stabilization plans; the plans have essentially run their course, since price increases have been very low in recent years. Nicaragua also succeeded in reducing inflation dramatically, but the country nonetheless remains deeply mired in crisis. Other countries experiencing high inflation rates, such as Ecuador, Mexico and Uruguay, succeeded in bringing them down. In Mexico, the annual rate of inflation dropped into the single digits, until the foreign exchange crisis in December 1994 set off a new wave of prices increases. The most recent inflation-fighting effort was Brazil's new stabilization plan, so far a success, after five failed attempts over the last nine years.

There were a few exceptions to this picture, one being Venezuela; in 1989 the country undertook a stringent adjustment and stabilization plan and succeeded in reducing inflation and balancing public sector accounts and its balance of payments, but later gradually abandoned the measures and suffered a return to macroeconomic turbulence. CDsta Rica and Honduras also experienced a resurgence of inflation along with fiscal ard balance-of-payments deficits.

The stabilization plan institut ;d by Brazil in 1994 was undoubtedly the most ambitious plan undertaken by a country in the region in recent years since the efforts by Argentina, Nicaragua and Peru in 1989-1991. It was implemented in three successive stages. In the first stage the aim was to achieve fiscal balance, the basic prerequisite for the plan. The second stage involved coordinating the price-setting process by creating a new indexing mechs nism with daily variations and making it mandai ory or strongly encouraging its use for all prices : n the economy. In the third stage, a new currency (the *real)* was introduced and went into circulation on 1 July, replacing all the old currency at i ts "URV" value (unit of real value) as of 30 June. The plan achieved promising results; the inflation rate dropped drastically from a rate o1'nearly 50% foi the month of June 1994 to a monthly average of a little over *2%* in the following twelve months, thanks to the elimination of much of the inertial component of price increases in Brazil.

2. Fiscal policy and public finances

Public finances in most Latin American countries in 1994 were more or less under control. In a few economies, however, the relatively sound footing of previous years was eroded, while in some others already posting heavy defi cits the situation remained critical or deteriorated even further.

The deep fiscal crisis experienced by most countries in the region in the 1980s obliged their governments to adopt drastic fiscal adjustment programmes closely tied to adjustments in external accounts. In the course of the decade, some countries began to show promising signs of improvement in their fiscal accounts, achieved, however, primarily through sharp cuts in spending, particularly on wages, capital investment and social programmes. Toward the end of the 1980s, more economies followed their example, so that between 1989 and 1991 fiscal adjustment became widespread in the region. A trend towards balanced public sector accounts set in and in most cases persisted into 1994.

In the early months of 1995, however, there was an abrupt deterioration in public sector finances in some countries as a result of the crisis that hit the region in December 1994. The drastic reduction in capital flows from abroad not only put pressure on foreign exchange markets, but affected the level of economic activity and hence of tax revenues, and this in turn made a high level of public expenditure unsustainable. The situation forced severe new fiscal adjustments, which basically entailed increasing the tax burden and applying cost control measures.

a) Trends in fiscal balances

Trends in fiscal balances were not uniform across Latin America and the Caribbean; in this respect countries can be divided into five categories. The first category covers those who had their fiscal accounts relatively well adjusted by the end of the 1980s (Chile, Colombia and Paraguay) and were still in a comfortable position in 1994. In Chile, the non-financial public sector again posted a surplus of 2% of GDP, marking over ten years of balanced public finances; Colombia and Paraguay managed to increase their positive balances (see table II-l).

In the countries that make up the second category, the process of fiscal adjustment intensified in 1994. In Peru, which began the decade mired in deep crisis, central government accounts moved from a deficit equal to 1.6% of output in 1993 to a surplus of 2.1% in 1994, although part of this achievement was due to non-recurring income from srivatization. Ecuador also managed to reduce it s non-financial public sector deficit to just 0.2% of GDP. Brazil swung from a deficit of 1.3% of OP in operating terms to a surplus of 1.2%, a trend that accelerated in the second half of] 994 due to the sharp drop in inflation.

The third category comprises a number of countries that had made major progress in previous years in controlling public finances but suffered setbacks in 1994. Argentina, Mexico and the Dominican Republic, for example, recorded a modest deficit in 1994, whereas in 1993 they had shown a surplus or a nearly balanced budget. Uruguay, which adjusted its public sector accounts in 1991, experienced a setback in 1993 and an even deeper deficit, equal to 3% of output, in 1994. The strious external account crises that developed in <\rgentina and Mexico towards the end of 1994 al so had a heavy impact on their fiscal situations aid obliged the governments of both countries tc adopt drastic adjustment measures in the early m onths of 1995. The government that took office in Uruguay in March 1995, fearing that the extern al capital flow crisis might accentuate the deficit, also implemented a new fiscal adjustment programme.

The countries in the fourth category are those whose deficits were large but were financed with external resources granted on concessional terms; of this group i, Bolivia and El Salvador succeeded in reducing their deficits. Honduras and Nicaragua, in contrast, ran up substantial deficits of 5% and 10% of output, respectively, although ttey were still able to finance them completely with external capital, grants and "soft" loans. In Guatemala, finally, the central government deficit was held to 1.5% of GDP, despite a decline in current revenues, offset by an equivalent ci it in spending. To that figure should be added a quasi-fiscal deficit of 1%.

The final category covers countries with a relatively complicated fiscal situation in which the deficit was financed with internal resources,

Figured by excluding the inflation component of nominal i rest rates.

Table II-1
LATIN AMERICA AND THE CARIBBEAN: PUBLIC SECTOR DEFICIT (-)
OR SURPLUS AT CURRENT PRICES[a]

(Percentage of GDP)

Country	Coverage	1987	1988	1989	1990	1991	1992	1993	1994[b]
Argentina	NNFPS	-4.8	-7.7	-3.2	-3.8	-1.6	-0.1	-0.1	-0.4
Bolivia	NFPS	-7.3	-5.8	-4.8	-3.9	-3.7	-4.8	-5.8	-4.2
Brazil	Nominal CPS[C]	-32.3	-53	-83.1	-26.9	-28.2	-48.4	-65.6	-39.2
	Operating CPS[cd]	-5.7	-4.8	-6.9	1.2	-0.2	-2.84	-1.25	1.2
Chile	NFPS	1.9	1.7	2.8	3.5	2.4	2.8	2.0	2.0
Colombia	NFPS[e]	-1.9	-2.2	-1.9	-0.6	-	-0.2	0.3	2.6
Costa Rica	NFPS	-	0.1	-	-2.5	-0.1	0.7	0.6	-6.9
	CG	-2.0	-2.5	-4.1	-4.4	-3.1	-1.9	-1.9	-7.0
Ecuador	NFPS	-9.6	-5.3	-1.4	0.1	-1.0	-1.7	-0.4	-0.2
El Salvador	CG	-3.8	-3.2	-4.9	-3.6	-5.2	-5.2	-3.3	-2.1
	NFPS			-5.8	-2.8	-4.9	-6.5	-3.6	-2.0
Guatemala	CG	-2.4	-2.4	-3.8	-2.3	-0.1	-0.5	-1.5	-1.5
Haiti	CG				-1.3	-0.5	-2.8	-3.8	-5.4
Honduras	CG	-8.1	-6.9	-7.4	-6.4	-3.3	-4.9	-9.3	-5.2
Mexico	CPS	-14.5	-10.9	-5.0	-2.8	3.3	1.6	0.7	-0.3
	CG	-14.3	-9.7	-5.1	-2.8	3.5	4.8	0.8	-0.4
Nicaragua	CG	-16.6	-26.6	-6.7	-17.1	-7.5	-7.6	-7.3	-9.7
	CPS				-17.2	-7.9	-8.3	-8.6	-12.1
Panama	CG	-4.5	-53	-0.7	6.8	-2.7	-1.4	-0.4	-0.8
Paraguay	NFPS				5.2	2.9	0.1	1.2	3.3
	CG	-0.1	0.7	1.5	3.0	4.4	-0.1	-0.7	0.8
Peru	CG					-1.5	-1.5	-1.6	2.1
	NFPS	-7.1	-8.3	-6.9	-43	-1.4	-1.3	-1.3	2.4
Dominican Republic	CG	-2.2	-1.6	-0.1	0.3	2.8	2.9	-0.4	-1.1
Uruguay	CPS		-4.5	-6.1	-2.5	0.0	0.5	-1.5	-3.0
	CG	0.2	-2.0	-3.4	-0.1	0.4	0.3	-1.2	-2.3
Venezuela	NFPS	-4.4	-8.6	-1.1	0.2	0.2	-5.8	-3.5	-13.8
	CG	-5.0	-6.2	-1.0	-2.1	2.8	-3.6	-3.4	-6.5

Source: ECLAC, based on official figures.
Key: CG = central government. NFPS = Non-financial public seaor. NNFPS = National non-financial public sector, excluding provinces and municipalities. CPS = Consolidated public sector.
Calculated on the basis of figures in local currency at current prices. Preliminary figures. " Estima es based on finance requirements of consolidated public sector. Excludes inflation component of interest rates. [e] Does n ot include transfers.

derived in whole or in part from monetary creation. In Costa Rica, the central government deficit expanded to 7% of GDP from a level of less than 2% the year before. Venezuela's fiscal deficit, already high, rose even higher, chiefly because of the banking crisis that forced the public sector to provide massive financial assistance to the banks. Haiti's public finances, already in a state of collapse during the previous two years, again shrank drastically, leaving the authorities no choice but to finance the huge fiscal deficit by issuing money ind postponing external debt service payments.

b) **Trends in fiscal income**

In 1994, as in the previous two years, fiscal income increased in most countries in the region with just six exceptions (Costa Rica, the Dominican Republic, Ecuador, Guatemala, Haiti and Honduras). In consequence, non-financial public sector income in a

In some cases only information on central government income was available.

numberofeconomies reached levels higher than in 1990. Ten countries (Argentina, Chile, Colombia, the Dominican Republic, El Salvador, Nicaragua, Panama, Paraguay, Peru and Uruguay) achieved levels that exceeded those recorded at the start of the decade by 25% or more in real terms (see table II-2). In Brazil, general government income continued to climb back after contracting in 1991-1992. Where fiscal income increased, it was due to the expansion of both tax revenues and earnings of public sector enterprises; in some cases non-recurring income from privatization was also a factor. Declines in fiscal income were largely due to the problems that curtailed tax revenues in certain countries.

i) Tax revenues

One of the most significant developments in public finances in the region in 1994 was the fact that in six countries (Bolivia, Brazil, El Salvador, Paraguay, Peru and Venezuela) tax revenues increased by over 10% in real terms, in some of them for the second or third straight year. In Venezuela, non-petroleum tax revenues underwent a remarkable expansion (40%), nearly triple the figure for 1990. In contrast, petroleum-related tax revenues declined. Some other countries (Argentina, Colombia, Mexico, Nicaragua and Panama) also achieved increases ranging from 4% to 7%. In Chile, on the other hand, tax revenues increased very little because of tax cuts. In the other seven countries of the region, tax revenues declined (see table II-2).

As in previous years, the increases in tax revenues in Latin America were due to a variety of factors, including expanded economic activity and imports, low and declining inflation rates, greater efficiency on the part of collecting agencies, and tax reform. Revived production activity expanded the tax base in most countries of the region, thereby contributing to the increase in tax revenues, generally with high elasticity in relation to output. Significantly greater imports, generally subject to high tax rates, also brought about a big increase in tax revenues. Import liberalization policies introduced in recent years also had a major impact, since the larger volume of imports more thancompensatedforthe re(luction in tariff rates.

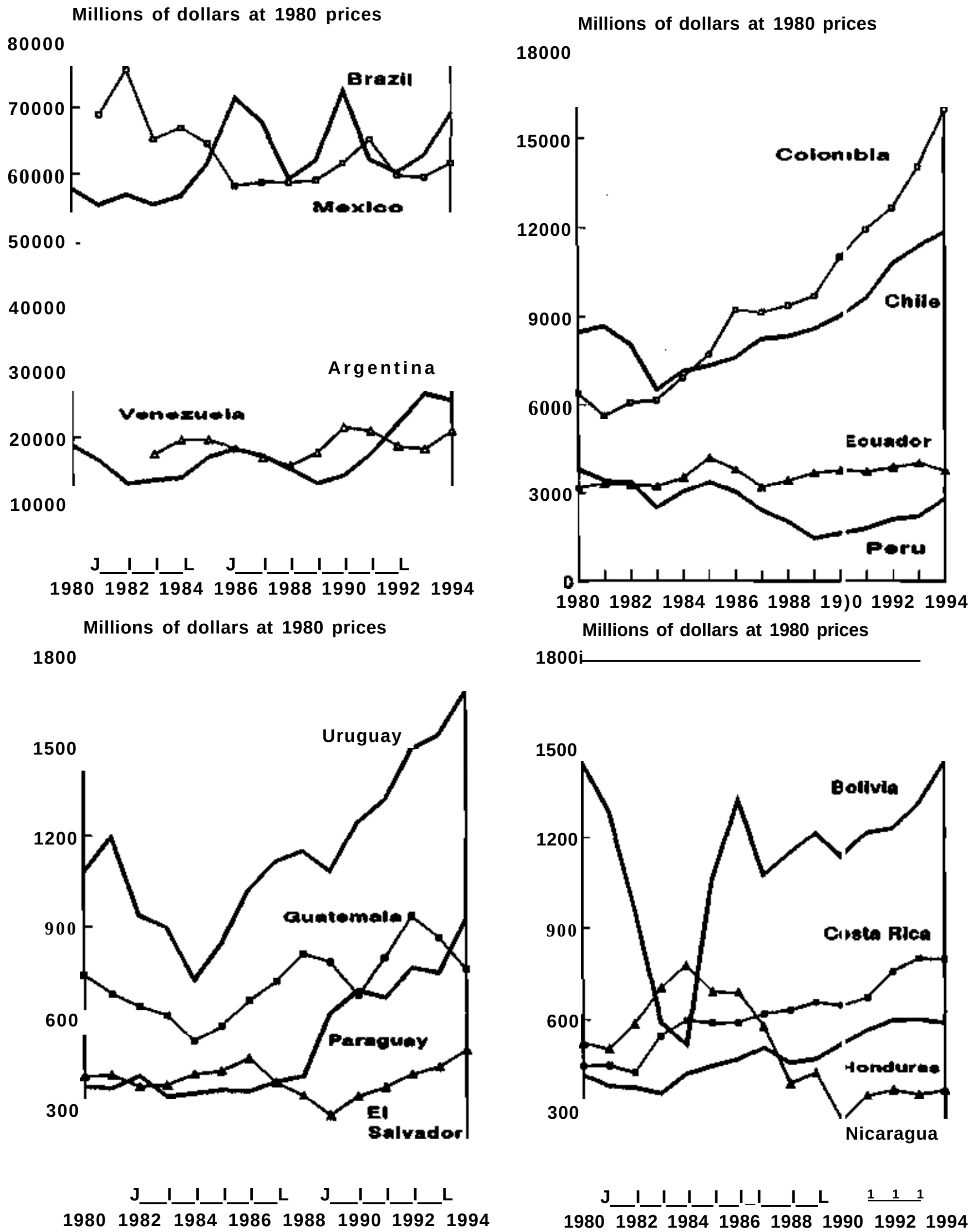
In nearly all countries in which tax revenues increased, economic activity ami imports also increased. In Venezuela, however, the expansion in non-petroleum tax revenues was due to new taxes, while older taxes brought in less because of rising inflation and slumping economic activity. In Costa Rica, the Dominican Republic, Ecuador, Guatemala and Uruguay tax revenues declined in real terms despite an increase in the level of economic activity; the decline was due to a combination of other factors, such as tax cuts and a drop in tax revenues deriving from petroleum.

The fact that a number of countries that had suffered in the past from runaway inflation were able to bring their inflation rates firmly under control in 1994 also contributed significantly to higher tax revenues. Rising inflation had hurt revenues because of the widening gap between the valuss of the tax liability when generated and when actually collected by the State. The sow-down in inflation beginning in 1991 produced the opposite effect. The increase in revenues from this cause was especially noticeable in 1994 in Brazil and Peru, as it had bei;n earlier in Argentina.

Major improvements in the efficiency of the collecting agencies were also obüervable, and the effect was reflected in the high elasticity of tax revenues in relation to output Tax evasion nevertheless continued to be extensive, as more efficient collection methods were countered by the growing inform! il component in the economy. The phenomenon was particularly noticeable in Peru, vhere the tax ratio, although up significantly in 1994 to 10.5%, still remained far below the levels recorded prior to 1987. In Brazil, despite improvements in the two previous years, the tax ratio was just 22%, nearly four per cent lower than the rates recorded for some years in the previous decade.

Tax reforms introduced in 1994, combined with reforms still in effect from earlier years, undoubtedly contributed to the increase in fiscal income in a number of countries. The chief purpose of the reforms was to correct the

Figure II-l
LATIN AMERICA AND THE CARIBBEAN: CURRENT INCOME OF NON-FINANCIAL PUBLIC SECTOR [a]



Source: ECLAC.

a In Costa Rica, El Salvador, Quatemala, Honduras, Nicaragua, Paraguay, Peru and Uruguay the current Income figures shown pertain to the contrai government: tor Chile they pertain to general government. For Brazil he figures shown are general government tax evenues.

Table II-2

LATIN AMERICA AND THE CARIBBEAN: PUBLIC SECTOR INCOME

Country	Coverage	Category	Index (1987=100;>[a]				Percentage of GDP [b]				Percentage ol annual variation		
			1980	1985	1990	1994°	1980	1990	1993	1994°	1992	1993	1994[e]
Argentina	NNFPS	Current income	109.6	99.1	82.2	149.3	16.1	13.2	19.9	17.9	26.0	21.1	-3.7
	NNFPS	Tax revenues	114.9	94.8	86.8	157.5	15.0	12.4	18.4	16.8	26.7	17.8	-2.2
Bolivia	NFPS	Current income	134.9	98.1	105.8	135.5	33.1	25.7	26.8	28.4	1.2	7.0	10.6
	NFPS	Tax revenues	69.8	73.8	87.9	172.5	5.0	6.2	9.3	10.5	26.3	13.2	16.8
Brazil	GG	Tax revenues[e]	85.4	90.9	107.0	102.4	23.7	25.5	21.1	22.0	-3.0	4.3	10.4
Chile	GG	Current income	102.8	88.7	109.2	144.0	32.8	26.6	27.4	27.5	11.9	5.4	4.4
	GG	Tax revenues	81.9	88.6	97.6	154.2	18.7	17.0	21.3	21.0	14.0	10.7	2.9
	GG	Operating income	155.1	89.0	138.3	118.7	14.1	9.6	6.1	6.5	6.4	-9.6	9.5
Colombia	NFPS	Current income	70.0	84.2	120.5	175.1	19.7	23.6	27.2	29.3	6.0	11.0	13.9
	NFPS	Tax revenues	76.9	82.4	122.0	186.0	13.5	14.9	19.1	19.4	8.0	18.6	7.4
Costa Rica	CG	Current income	72.2	94.8	104.3	129.4	12.6	14.5	15.5	14.9	2.9	5.6	0.1
	CG	Tax revenues	69.8	95.4	109.1	137.0	11.2	14.0	15.3	14.5	3.2	6.5	-0.5
	NFPS	Current income			86.7	113.2	135.7	26.1	28.2	25.9	9.9	5.7	4.1
Ecuador	NFPS	Current income	101Í4	13¿3	137.5	141.1	24.1	27.1	26.6	24.1	4.8	5.2	-5.5
	NFPS	Petroleum income	135.0	234.6	215.9	156.3	8.7	11.6	8.7	7.3	2.9	-8.0	-12.7
	NFPS	Non-petroleum income	88.8	99.6	108.2	135.4	15.3	15.5	17.9	16.9	0.6	13.1	-2.0
El Salvador	CG	Current income	106.3	110.0	88.1	128.0	11.7	9.8	11.1	11.8	2.0	5.4	12.8
	CG	Tax revenues	109.3	103.1	89.0	127.4	11.1	9.1	10.3	10.8	6.3	12.1	11.4
Guatemala	CG	Current income	103.2	79.5	93.6	105.6	9.5	7.9	9.0	7.6	;7.5	-7.5	-12.2
	CG	Tax revenues	108.6	72.4	93.9	108.7	8.6	6.8	7.8	6.8	18.4	-1.8	-9.9
Haiti	CG	Current income		87.5	27.5			7.8	5.7	3.4	-••3.6	-12.1	-46.8
	CG	Tax revenues		87.3	28.6			7.4	5.5	3.4	-••4.6	-10.7	-45.6
Honduras	CG	Current income	82Í2	88.0	102.4	11 ¿8	16Í5	16.4	16.8	16.8	5.9	0.2	-1.2
	CG	Tax revenues	79.3	86.7	97.0	114.2	15.2	14.8	15.7	15.6	9.3	2.0	-1.8
Mexico	CG	Current income	88.7	106.6	108.7	120.3	16.5	17.1	17.3	17.1	6.8	-1.8	2.3
		excluding PEMEX		101.2	122.2	148.5		13.3	14.2	14.6	9.4	-0.4	6.5
	CG	PEMEX income		118.8	78.4	56.9		3.8	3.1	2.5	2.9	-7.9	-16.9
	CPS	Total income		110.1	104.9	105.0		29.6	26.8	26.8	8.3	-0.2	3.4
Nicaragua	CG	Current income	90Ü2	119.3	46.6	64.1	25.2	14.9	19.6	20.1	5.6	-4.3	5.2
	CG	Tax revenues	87.6	112.9	46.5	67.4	22.2	13.5	18.6	19.2	8.9	-4.0	5.9
Panama	CG	Current income	78.4	91.8	80.3	112.6	19.1	18.5	20.1	19.7	16.2	1.3	2.5
	CG	Tax revenues	78.1	88.3	74.6	103.6	13.9	12.5	13.1	13.1	12.2	1.1	4.9
Paraguay	CG	Current income	96.7	93.5	177.5	238.5	9.2	12.4	12.4	14.9	14.7	-2.0	23.8
	CG	Tax revenues	99.9	92.6	169.6	202.9	8.2	10.2	9.5	11.0	•1.7	14.6	19.6
Peru	CG	Current income	158.5	138.9	66.7	117.5	17.7	8.4	10.8	12.4	16.4	5.0	29.4
	CG	Tax revenues	156.4	131.3	68.4	104.4	16.6	8.3	9.3	10.5	7.6	4.7	27.2
Dominican	CG	Current income	73.6	72.2	72.1	119.7	13.5	10.3	16.1	15.0	25.3	7.0	-3.1
Republic	CG	Tax revenues	65.8	74.9	76.5	124.8	10.8	9.8	15.0	14.0	30.1	10.1	-2.6
Uruguay	CG	Current income	97.2	75.8	111.8	151.1	16.2	17.8	19.5	20.4	13.0	3.1	9.3
	CG	Tax revenues	96.6	77.0	109.8	123.8	14.9	16.1	16.9	15.4	13.5	2.0	4.8
Venezuela	CG	Current income	119.9	129.7	130.8	119.5	21.7	22.7	16.8	18.5	-1S.9	-6.5	6.7
	CG	Petroleum income	166.9	142.4	204.8	108.4	15.9	18.7	10.1	8.8	-31.8	-14.7	-15.4
	CG	Tax revenues	67.9	115.5	49.0	131.7	5.9	4.1	6.7	9.7	42.8	9.3	39.8
	NFPS	Current income		116.9	127.6	124.6		33.2	24.3	28.9	-11.0	-2.0	14.9
	NFPS	PDVSA income			197.8	140.8		25.8	14.7	16.4	-23.7	-7.7	8.0
	NFPS	Non-petroleum income			56.9	108.3		7.4	9.6	12.5	H.O	8.2	25.3

Source: ECLAC, based on official figures.

Key: CG = Central government. GG = General government. PEMEX = Petróleos de Mexico. PDVSA = Petróleos de Venezuela. CPS = Consolidated public sector. NFPS = Non-financial public sector. NNIPS = National non-financial public sector, excluding provinces and municipalities.

[a] Calculated on the basis of figures in 1980 dollars. [b] Calculated on the basis of figures in local currency at current prices. [c] Preliminary figures. Includes income from sales by public sector enterprises and autonomous agencie s. [e] Includes Treasury, taxes on the circulation of merchandise and services, and social security contributions.

imbalance in public finances, and to achieve that aim tax rates were raised, new taxes created and exemptions eliminated orreduced."

ii) Other public sector income

Other important sources of public sector income were income from public sector enterprises and non-recurring income from sales of State assets.

There were divergent trends in public enterprise income in 1994. In the countries in which such fiscal income derived largely from State-owned oil-exporting enterprises, the figures declined. In countries where metal exports predominated, on the other hand, income rose significantly, reflecting higher international prices. With regard to income from domestic sales of goods and services, revenues of public sector enterprises held their own or increased in some countries thanks to rate adjustments that enabled them to catch up with the general increases in prices. In some economies, such income was affected by the privatization of public sector enterprises.

In Mexico, petroleum revenues declined 17%, while in Venezuela, where lower prices were offset by growth in gas and oil exports, they increased 7%. In Ecuador, the surplus posted by public sector enterprises was lowered by a combination of lower prices for crude and a lag in some rates (electricity, communications). A similar situation was observable in Bolivia, where income from sales by pubic enterprises declined 1.5% in real terms, primarily as a result of the drop in the price of natural gas sold to Argentina.

In Chile, on the other hand, the surplus realized by the Corporación Nacional del Cobre (CODELCO), after declining sharply the year before, rebounded thanks to the rise in the price of copper, so that the enterprise was able to increase its transfers to the central government. Other Chilean public sector enterprises duplicated the results of the previous year. In Colombia, the net operating income of public sector enterprises went up 13% in real terms, bolstered by the surpluses of the electric power sector and the State-owned oil company.

In Paraguay, public sector enterprises again generated surpluses, thanks in large measure to adjustments in the prices of the goods and services they provided. In addition, there was a big jump in royalty income ¡elated to the operation of the Itaipú hydroelectric dam. In Peru, operating results of public sector enterprises improved as a result of increases in prices and rates, particularly for electricity and telephone services. In Uruguay, public sector enterprises once again posted a profit thanks to price and rate adjustments, enabling them to transfer large sums to the central government. In El Salvador, public sector enter] >rises posted a significant operating surplus, du; in part to an increase in rates.

In Argentina, in contrast, savings of public sector enterprises once again declined, largely because the enterprises remaining after privatization were limited in scope. In Brazil, on the other hand, public sector enterprises were able to raise their rates in the first half of 1994, and although rates were later frozen, the companies were able to make up a small operating deficit.

In a few countries, finally, public sector enterprises posted negative results. In Costa Rica, for example, in a change from previous years when their surpluses helped to offset the central government deficit, the em erprises had no contribution to make to the public coffers, chiefly because of investments in telephone equipment and to a lesser extent in electric power plants. In Honduras, public sector enterprises posted a large deficit due to spending on an emergency programme to alleviate the electric power crisis. In the Dominican Republic, public sector enterprises and autonomous agencies performed less well in 1994, which translated into a significant deficit for the non-financial public sector as a whole.

Non-tax income collected by the various levels of government[4], a category covering a fairly heterogeneous group of it ;ms, increased

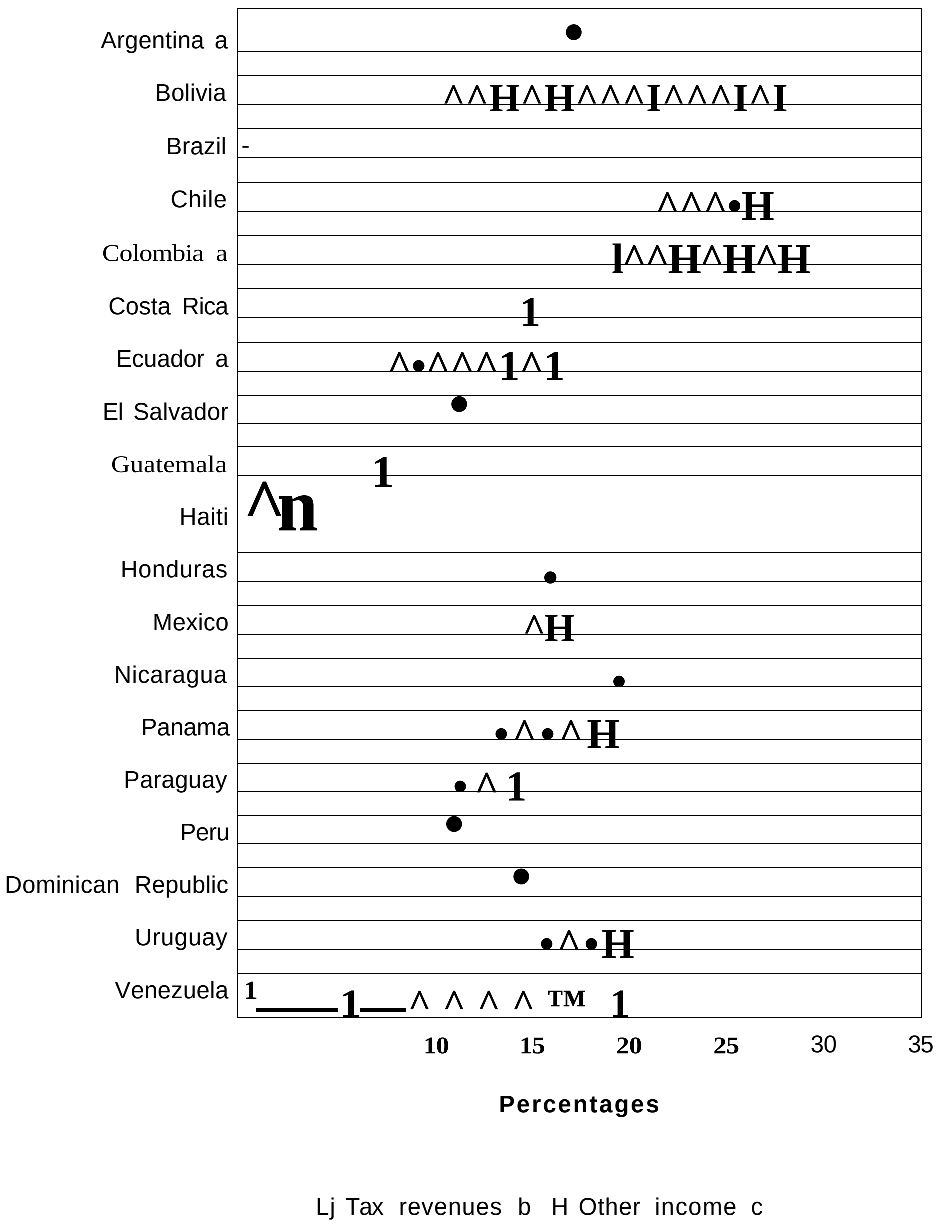
[3] Tax reforms in recent years are discussed later in this chapter under the heading of "Structural reforms".

[4] Normally, social security contributions would be included under this category, but were excluded because 1994 information was not available.

Figure II-2

LATIN AMERICA AND THE CARD3BEAN: CURRENT INCOME OF CENTRAL GOVERNMENT, 1994

(As a percentage of GDP)



Source: ECLAC, based on official figures.

a Income of non-financial public sector, b Does not include revenues from taxes on natiral resources. c Includes non-tax income plus revenues from taxes on natural resources.

in 9 of the 15 countries for which information was available. Notable among them were Uruguay, Paraguay and Colombia, which achieved increasesofoveronepercentofoutput; Chile and Peru also made gains, to a lesser degree.

In addition, in 1994 some countries of the region again realized proceeds from the sale of public sector enterprises and other assets; Peru and Colombia were outstanding examples. In Argentina and Mexico, on the other hand, where income from such sources had increased markedly in previous years, the sums realized in 1994 declined. Privatization continued in Brazil, but proceeded at the halting pace characteristic of previous fiscal years. In the other countries of the region, income generated from the sale of public assets was minimal.

c) **Trends in public expenditure**

In 1994, public sector expenditure increased in real terms in most of the region. In 14 of the countries for which information was available expenditure increased, although the percentage increase and the reasons for it differed widely. Expenditure declined in only five countries, compared with eight the year before. The biggest jumps in total expenditure were in Costa Rica, Peru and Venezuela, where central government spending rose by percentages ranging from 19% to 31%. In Venezuela, non-financial public sector expenditure increased 50% because of the financial assistance that had to be given to the banking system when it faced massive withdrawals by depositors. There were also significant increases in Colombia, Mexico, Nicaragua, Paraguay and Uruguay (between 9% and 15%), while in Argentina, Bolivia, Chile, the Dominican Republic, El Salvador and Panama expenditures grew at a moderate pace (between 2% and 5%).

In Brazil, on the other hand, expenditure dropped slightly, and in Ecuador and Guatemala it declined significantly (between *6%* and 10%). In Honduras total central government spending was cut heavily (-17%) as an adjustment measure, after increasing an average of 20% a year over the two-year period 1992-1993. In Haiti, finally, spending declined drastically for the fourth consecutive year (see table II-3).

In most countries of the region public sector expenditure dropped sharply -in real terms- during the 1980s as a result of ttie adjustments undertaken in the wake of the external debt crisis. In the current decade, however, th ; pendulum has begun to swing back in some countries, as can be seen from the fact that in 1994 the level of spending reached historical lighs in nine countries (Argentina, Bolivia, Chile, Colombia, Costa Rica, the Dominican Republic, Paraguay, Uruguay and Venezuela), while Honduras reached a high in 1993. In Brazil, on the other hand, total expenditure increased in the previous decade, reaching a peak in 1987, and thereafter declined steadily except for 199ÍL In most other countries of the region, despits a significant rebound in recent years, spending in 1994 still remained below the levels of the early 1980s. Haiti and Nicaragua, in contrast, spent in 1994 only one fourth and one half, respectively, of the amounts the *y* spent in 1987 (see table II-3).

With regard to the separate components of expenditure, trends were mixed; although in most countries both current and capital expenditure increased, there were some countries in which these two components siowed opposite tendencies. In 10 of the countries in which total spending rose in real terms (Bolivia, Chile, Colombia, Costa Rica, Mexico, Nicaragua, Panama, Paraguay, Peru and Uruguay) both current and capital expenditure hcreased. Three other countries (Argentina, El Salvador and Venezuela) increased only their current expenditure, while reducing capital expenditure. In the Dominican Republic, on the other hand, capital expenditure accounted for the entire increase in total spending, while current expenditure declined slightly. All countries that reduced total spending made significant cuts in both current and capital expenditure.

In a number of the 19 countries for which up-to-date information on public finances was available, the < lata on expenditures referred only to the central government only (and generally included transfers to local governments, but not their expenditures). Information on the total expenditure of the non-financial public sector was available only for a subset of cou itries.

Interest payments on both external and domestic debt were lower in seven countries of the region, but higher, in some cases appreciably higher, in another eight. One reason for the decline was a reduction in external debt as a result of agreements signed in the framework of the Brady Plan. In some countries, interest payments on domestic debt were lower because of a drop in nominal interest rates, linked, for the most part, to the slowing rate of inflation, although the decline in real terms was considerably less. In Brazil, in particular, real interest payments declined for the second year following a sharp increase in 1992. The decline was due to lower real domestic interest rates, which no longer had to be used intensively as monetary instruments to control runaway inflation and to counteract the rapid expansion of the money supply caused by a large increase in international reserves. In the second half of 1994 the trend began to shift, and real interest rates were again raised considerably to help control inflation, when difficulties arose with the use of fiscal instruments.

i) Spending policy

In contrast to previous years, for a variety of reasons countries departed from the strict policies of austerity in public sector spending introduced at the end of the previous or beginning of the current decade. Fiscal adjustment policies ran into serious difficulties because of the inflexible structure of public expenditure; new needs arose that could not be postponed, or it was found that expenditure could not be indefinitely compressed.

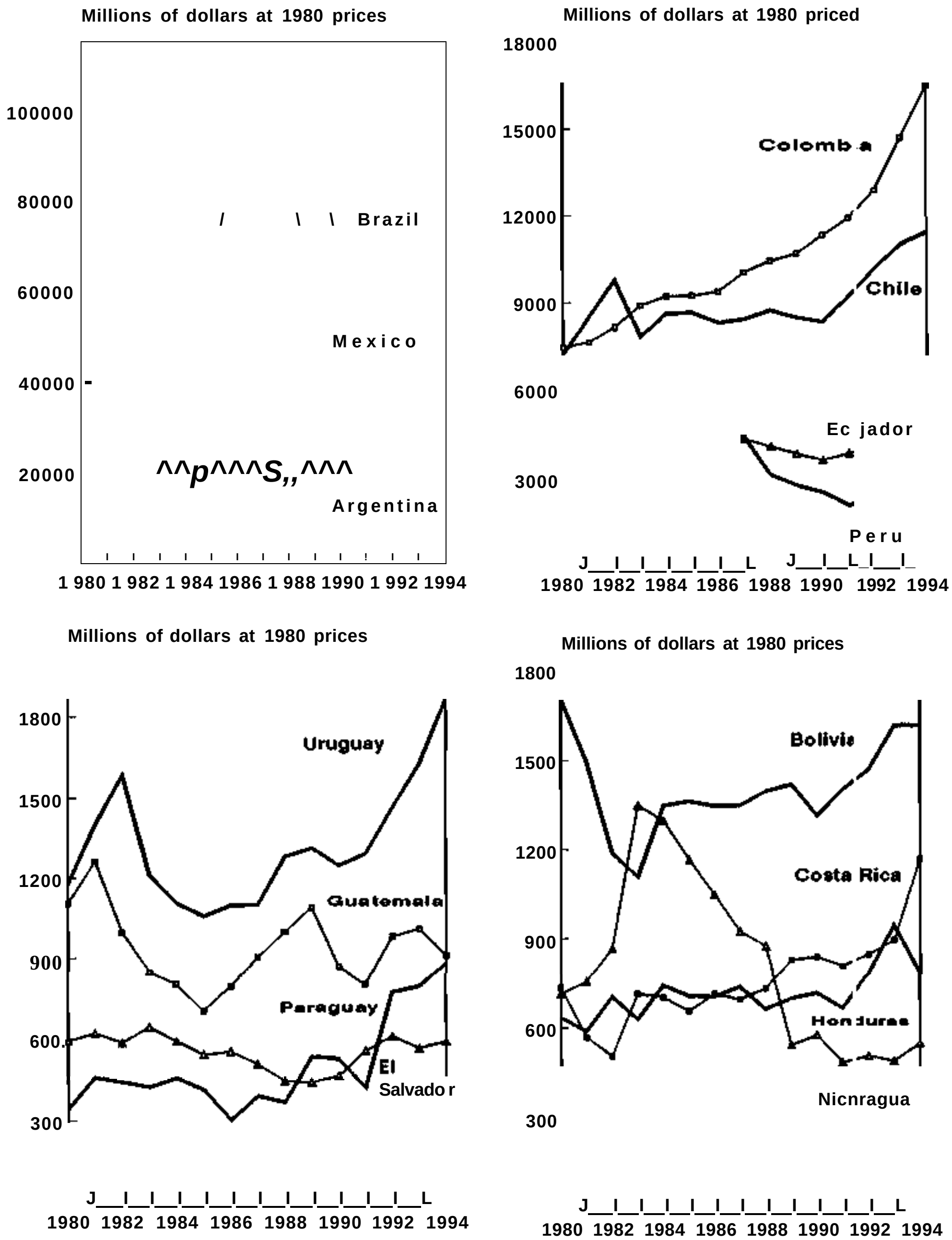
Seven countries (Costa Rica, the Dominican Republic, Mexico, Nicaragua, Paraguay, Peru and Uruguay) adopted expansive fiscal policies. In Costa Rica, the decision was reflected in increased consumption outlays and interest payments. The heavy increase in expenditure, however, was caused by other factors over which the Government had very little control, such as the above-mentioned transfers to the financial system. Mexico pursued an obviously expansive policy aimed at supporting the sectors where government participation was socially most productive, promoting economic recovery and enhancing the social component of spending. All these aims resulted in an increase in real current expenditure (10%), in a context of steadily declining interest rates (-1:1%). Capital expenditure expanded 25% in real terms, most of it spent as part of the National Solidarity Programme and in the areas of communications and transportation.

In Peru, both current and capiial expenditure expanded explosively. The expansion was made possible by an impressive improvi ment in public sector finances due to an increase in income that was quite remarkable, even setting aside the large sums generated by privatization. Public sector investment increased 65% in reil terms, since external financing was also available. Uruguay increased its expenditures considerably, primarily through social security transfers over which the Government had no control and through a 31% real increase in capital expenditure as a result of the expansive policy adopted by the authorities in th s area. There was also a rapid rise in wage payments, while interest payments on the public debt continued to decline.

The Dominican Republic pursued an expansive policy on capital expenditure, increasing it nearly 8%, while current outlays declined 4%, reflecting a decliie in interest payments. In Nicaragua an expans: ve investment policy was pursued in an attempt to make up for enormous deficiencies in infrastructure, the legacy of years of crisis and aimed conflict. Increased expenditure in Paraguay, particularly capital investment, was covered by a comfortable surplus in public finances resulting from the tax reform introduced in 1992.

Most Latin America countries faced the problem of in inflexibility in the public budget due to the large number of people employed in the public sector and large inteiest payments equalling as much as 3% of oitput. In nine countries, moreover, the trerd in public expenditure was due to factors beyond the control of the authorities. In Colombia, which up to two years ago had been able to adhere to a policy of moderate growth in public sector spending, outlays began to mounl substantially starting in 1993, essentially becau se of massive transfers from the central Government to the regional and local governments. Tie increase in transfers was based on coistitutional

Figure II-3
LATIN AMERICA AND THE CARIBBEAN: TOTAL EXPENDITURE OF NON-FINANCIAL PUBLIC SECTOR[a]



Source: ECLAC.

a For Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, Paraguay, Peru and Uruguay, the total expenditure shown pertains to the central government only; for Brazil and Chile it pertains to general government.

Table II-3
LATIN AMERICA AND THE CARIBBEAN: PUBLIC SECTOR EXPENDITI RE

Country	Coveragiî	Category	Index (1987=100)[a]				Percentage of GDP[b]				Percentage of annual variation[h]		
			1980	1985	1990	1994[c]	1980	1990	1993	1994[e]	1992	1993	1994[e]
Argentina	NNFPS	Total expenditure	109.1	93.5	81.0	111.1	21.3	17.3	20.6	18.9	4.9	15.6	-8.3
	NNFPS	Current expenditures	103.5	98.5	95.5	134.0	15.2	15.4	18.8	17.2	2.8	18.5	-8.5
	NNFPS	Interest	51.7	141.0	95.6	95.0	0.7	1.4	1.3	1.1	7.6	-16.5	-15.4
	NNFPS	Capital expenditures	133.2	74.5	46.4	51.7	5.0	1.9	1.8	1.7	:¡5.o	-8.1	-5.6
Bolivia	NFPS	Total expenditure	126.0	100.9	97.5	120.0	38.9	29.8	32.9	33.0	4.7	9.9	0.2
	NFPS	Current expenditures	127.3	109.0	92.1	114.0	31.1	22.3	24.6	24.8	2.3	13.9	0.8
	NFPS	Interest	85.6	167.4	80.8	126.7	1.4	1.3	1.8	1.8	-11.3	0.1	0.7
	NFPS	Capital expenditures	121.3	70.0	117.9	142.7	7.8	7.5	8.3	8.2	11.5	-0.4	-1.4
Brazil	GG	Total expenditure	68.6	79.5	82.6	74.6	24.7	25.5	22.3	20.8	9.0	-2.5	-1.5
	GG	Interest	27.9	94.5	54.1	53.3	2.0	3.3	3.1	2.9	11.8	-7.0	-1.1
Chile	GG	Total expenditure	85.5	102.6	99.0	136.0	28.0	24.7	26.6	26.6	10.4	8.1	4.3
	GG	Current expenditures	84.4	99.3	99.0	133.6	23.4	21.0	22.4	22.1	10.4	8.1	2.9
	GG	Interest	12.7	78.2	113.5	76.4	0.3	2.1	1.4	1.1	-:8.2	-5.2	-17.2
	GG	Capital expenditures	91.7	121.3	99.1	149.7	4.6	3.8	4.1	4.4	10.4	8.3	11.7
Colombia	NFPS	Total expenditure	74.1	91.9	112.7	164.4	23.0	24.3	28.5	30.3	8.1	14.1	12.4
	NFPS	Current expenditures	73.0	85.5	111.0	160.1	15.9	16.8	18.8	20.7	6.4	5.5	16.4
	NFPS	Interest	29.4	60.2	98.7	97.8	1.7	3.9	3.4	3.3	•6.3	-6.1	2.6
	NFPS	Capital expenditures	76.7	107.1	116.5	174.5	7.1	7.5	9.9	9.6	11.1	40.3	2.5
Costa Rica	CG	Total expenditure	105.4	94.4	120.6	168.4	20.7	19.0	17.5	21.9	5.0	5.6	30.7
	CG	Current expenditures	94.9	91.4	123.5	174.4	16.2	16.8	15.5	19.6	2.7	4.2	32.1
	CG	Interest			138.8	205.5		3.3	3.1	4.1	•5.5	-10.4	38.0
	CG	Capital expenditures	173^5	114ÍÒ	101.7	129.6	4.6	2.1	2.0	2.2	30.8	18.1	19.9
	NFPS	Total expenditure		91.5	122.8	170.0		28.6	27.6	32.7	6.5	5.8	23.8
	NFPS	Current expenditures		89.6	126.2	170.1		23.9	22.2	26.6	0.7	5.5	25.0
	NFPS	Interest		80.6	138.9	204.3		3.4	3.1	4.1	•5.4	-10.2	37.6
	NFPS	Capital expenditures		99.2	108.3	169.7		4.8	5.4	6.1	40.3	7.0	18.7
Ecuador	NFPS	Total expenditure	107.5	110.8	95.1	98.8	36J	27.0	26.9	24.3	7.5	0.1	-6.1
	NFPS	Current expenditures	97.4	106.0	88.4	90.8	25.8	19.5	19.4	17.4	9.5	0.8	-6.8
	NFPS	Interest	73.9	124.3	147.6		3.1	5.1	4.4		-14.6	-7.0	••100.0
	NFPS	Capital expenditures	142.5	127.4	118.3	126.4	10.9	7.5	7.6	1Û	2.8	-1.7	-4.2
El Salvador	CG	Total expenditure	117.2	107.1	91.4	116.5	17.0	13.4	14.3	14.2	13.0	-7.4	4.6
	CG	Current expenditures	108.5	108.3	101.0	122.6	12.1	11.4	11.0	11.5	17	-0.6	10.2
	CG	Interest	46.2	111.7	123.5	194.0	0.4	1.2	2.0	1.6	-11.7	-3.0	-16.0
	CG	Capital expenditures	146.0	103.2	59.4	96.1	4.9	2.0	3.3	2.7	45.0	-24.6	-13.8
Guatemala	CG	Total expenditure	122.3	78.0	96.0	100.6	14.2	10.2	10.6	9.2	22.6	2.8	-9.9
	CG	Current expenditures	91.9	75.7	98.6	93.2	8.6	8.5	7.5	6.9	7.5	0.2	-4.9
	CG	Interest	0.0	62.4	91.9	83.8	0.0	1.1	0.9	0.9	-3 53	-2.4	0.3
	CG	Capital expenditures	249.8	87.6	85.1	131.8	5.6	1.7	3.1	2.3	95.7	9.9	-21.9
Haiti	CG	Total expenditure			100.0	70.1		9.1	9.6	8.8	-7.9	-0.6	-17.1
	CG	Current expenditures			100.0	69.5		8.8	9.3	8.5	-5.0	-2.0	-17.6
	CG	Interest			100.0	70.2		0.8	1.0	0.7	0.9	36.4	-30.8
	CG	Capital expenditures			100.0	92.7		0.3	0.3	0.4	-1.9	67.5	1.3
Honduras	CG	Total expenditure	8;6	918	97.3	106.5	252	22.8	26.7	22.4	17.3	21.0	-17.2
	CG	Current expenditures	68.9	87.0	92.9	92.6	16.0	17.2	17.8	15.4	7.0	11.4	-14.7
	CG	Interest						2.6	3.4	4.1	:».6	-8.9	20.5
	CG	Capital expenditures	150.3	128 J	113*8	158J	9.3	5.6	8.9	7.0	5'.2	46.3	-22.4
Mexico	CG	Total expenditure	58.0	84.7	69.1	68.7	19.7	20.0	16.9	17.9	-\.0	5.4	9.4
	CG	Current expenditures	48.3	79.3	66.7	66.3	14.7	17.3	15.0	15.5	-II.2	9.7	7.3
	CG	Interest		54.6	51.5	14.8		8.4	2.2	2.2	-2IÍ.5	-28.2	-12.3
	CG	Capital expenditures	142.7	127.2	89.7	89.7	5Ü	2.7	2.0	2.4	10.5	-18.5	25.5
	NFPS	Total expenditure		94.2	76.7	72.2		31.8	26.1	27.1	-:i.3	3.2	7.5
Nicaragua	CG	Total expenditure	76Í9	126.1	62.4	59.8	344	32.0	27.4	30.1	4.5	-3.3	12.7
	CG	Current expenditures	69.7	116.1	67.0	46.5	27.8	30.7	20.6	20.9	-.¡.6	-7.6	4.1
	CG	Capital expenditures	138.0	209.3	23.7	171.1	6.6	1.3	6.8	9.2	7:¡.o	12.3	38.8
Panama	CG	Total expenditure	95.2	83.1	68.1	95.6	28.4	19.1	20.5	20.4	11.9	-2.9	4.3
	CG	Current expenditures	74.5	78.5	70.2	88.4	21.1	18.7	17.9	17.9	2(1.4	-3.5	4.6
	CG	Interest	70.0	101.2	48.4	72.3	5.1	3.3	3.0	3.7	&;.0	-28.2	29.9
	CG	Capital expenditures	458.3	165.1	30.4	222.9	7.4	0.5	2.6	2.6	-4.'¡.3	1.3	2.4

Table II-3 (conclusion)

Country	Coverage	Category	Index (1987=100)[a]				Percentage of GDP[b]				Percentage of annual variation		
			1980	1985	1990	1994[e]	1980	1990	1993	1994[e]	1992	1993	1994[e]
Paraguay	CG	Total expenditure	87.8	105.6	134.1	225.1	8.4	9.4	13.2	14.2	84.6	2.8	10.9
	CG	Current expenditures	82.9	98.6	141.2	236.3	6.3	7.8	11.3	11.7	97.5	4.4	7.3
	CG	Interest	33.6	58.1	136.9	112.0	0.3	0.9	0.8	0.7	0.0	-7.6	-11.2
	CG	Capital expenditures	114.2	141.9	115.8	197.9	2.2	1.6	1.9	2.5	38.7	-5.8	31.1
Peru	CG	Total expenditure	109.7	98.1	57.4	77.9	22.4	13.3	12.8	15.1	14.7	8.7	33.0
	CG	Current expenditures	101.6	97.5	60.0	64.0	17.9	12.0	9.8	10.7	5.9	4.8	23.1
	CG	Interest	174.9	209.9	89.4	107.7	3.6	2.1	2.2	2.1	-24.3	12.1	7.6
	CG	Capital expenditures	160.6	102.0	41.2	164.6	4.5	1.3	3	4.4	68.8	23.4	65.3
Dominican	CG	Total expenditure	77.6	70.5	61.1	112.0	16.3	10.1	16.5	16.1	29.1	34.6	1.8
Republic	CG	Current expenditures	119.7	119.2	73.5	118.1	11.3	5.4	8.3	7.6	22.0	41.1	-4.0
	CG	Interest			571.6	1 530.0		0.4	1.3	0.9	-16.2	149.6	-29.5
	CG	Capital expenditures	433	30.8	51.0	107.0	5.0	4.6	8.2	8.5	36.5	28.7	7.7
Uruguay	CG	Total expenditure	107.1	96.1	113.3	169.5	17.7	17.9	20.7	22.7	13.4	11.1	14.8
	CG	Current expenditures	108.2	99.4	114.1	166.8	15.8	15.9	18.3	19.7	13.8	8.4	12.7
	CG	Interest	17.6	116.3	124.2	108.7	0.3	1.9	1.5	1.4	-8.1	3.6	-2.6
	CG	Capital expenditures	98.1	70.9	107.1	190.5	1.9	2.0	2.3	2.9	9.6	38.1	31.3
Venezuela	CG	Total expenditure	94.7	92.6	111.8	126.3	21.9	24.8	20.3	25.0	-5.4	-6.0	18.9
	CG	Current expenditures	81.3	91.6	114.4	143.6	14.3	19.3	15.5	21.6	-3.2	-4.2	34.4
	CG	Interest	43.8	73.4	119.5	134.1	1.6	4.1	3.1	4.1	8.1	-12.6	28.5
	CG	Capital expenditures	136.9	95.6	103.7	71.9	7.6	5.5	4.8	3.4	-11.3	-11.2	-31.2
	NFPS	Total expenditure		91.1	108.0	158.2		33.1	27.9	43.2	-3.3	-9.5	49.7
	NFPS	Current expenditures		96.3	113.2	205.2		20.6	18.0	33.3	-0.5	-3.1	78.7
	NFPS	Interest		89.5	145.5	145.0		5.6	4.6	5.0	24.6	-4.8	5.4
	NFPS	Capital expenditures		83.6	100.1	89.4		12.5	9.9	9.9	-7.3	-19.2	-3.0

Source: ECLAC, based on official figures.

Key: CG = Central government. GG = General government. NFPS : = Non-financial public sector. NNFPS = National non-financial public sector, excluding provinces and municipalities.

[a] Calculated on the basis of figures in constant 1980 dollars. [b] Calculated on the basis of figures in local currency at current prices. [c] Preliminary figures.

amendments allotting subnational governments a share in the tax revenues collected by the central Government. In Argentina, Costa Rica and Uruguay, greater expenditure was the result of a large increase in disbursements under the social security system. In the case of Costa Rica, additional factors were the considerable cost of export incentives and transfers related to the bankruptcy of Banco Anglo-Costarricense.

The Government of El Salvador was obliged to allocate large sums to defray the costs of the peace process, including grants to demobilized combatants and the creation of new institutions. In Honduras, adjustments in public sector expenditure were delayed by the need to make heavy investments in the electric power system to avoid a breakdown in the power supply. Nicaragua maintained a high level of expenditure because the public sector remained large despite gradual reductions, especially in the military. Bolivia incurred considerable expense to pay compensation to 3,000 workers who took early retirement from the State-owned enterprise, Corporación Minera de Bolivia (COMIBOL). In Venezuela, finally, already struggling with a heavy fiscal deficit, a widespread banking crisis developed that forced financial institutions to turn for help to the Deposit Guaranty and Bank Protection Fund (FOGADE).

Despite the above-mentioned inflexibility in the budget, most countries did attempt to control spending. In five (Brazil, Ecuador, El Salvador, Guatemala and Honduras) measures were implemented to make a significant reduction in total expenditures or at least in some of the major expense items. In Brazil, the economic authorities adhered to the view that balanced public sector accounts were basic to the success of the stabilization plan. In a major development, a constitutional amendment was introduced to reduce mandatory allocations of taxes and social security contributions, making it easier to achieve a cash management balance. The high cost of the public debt, however, continued to make it difficult to control expenditure.

In Ecuador, the public sector imposed strict fiscal discipline, reducing both current and capital expenditures in real terms. In El Salvador, the goal of fiscal policy was to trim expenditure, and the country succeeded in keeping current outlays within pre-set limits, despite pay increases and the expenses connected with the peace accords. Capital expenditures were 20% below target for lack of execution capacity. In Guatemala, public sector expenditure was subject to severe constraints in 1994 because of the reduction in the tax ratio for the second consecutive year. Public investment fell even below the extremely modest levels achieved in 1993. The tax reform in Honduras did not have a significant impact in 1994, but an improve ment in State finances was achieved by lowerin g public sector expenditure, which had risen disp roportionately the year before. The need to disburse funds to alleviate the electric utility crisis, however, prevented any very signif cant cut in spending.

Chile, finally, again posted a moderate increase in public sector expendit are that was in line with the growth in activity and with macroeconomic conditions, and this allowed it to maintain a good surplus in its public sector accounts.

As a result of the crisis at the end of 1994, a number of countries in the region were obliged to make drastic fiscal adjustments in the early months of 1995, involving not only tax increases but also spending cuts. The most striking examples were provided by Argentina and Mexico. The measures adopted in Argentina included a cut in wages and postponement of their paymenl. In Mexico, wage increases did not keep pace with inflation, which meant that wiges declined significantly in real terms.

3. **Foreign exchange policy**

Foreign exchange policy continued to be a key tool in combatting inflation, a method increasingly adopted by countries in the region since the close of the 1980s. Specifically, many Governments used the exchange rate as an "anchor" in price formation, while others adopted flexible exchange rates, with greater or lesser intervention by the monetary authority, in the context of a more open foreign exchange market. The massive influx of external capital fostered exchange rate appreciation, but the corollary, increased international reserves, made monetary management and export promotion harder.

Three countries (Brazil, Chile and Colombia) adopted measures intended to control short-term external capital flows by imposing restrictions or reserve requirements to discourage their influx. It was not clear, however, that the measures had any significant effect, since the currencies of these three countries appreciated considerably in 1994. Most of the smaller economies did not restrict external capital flows, [n particular, Ecuador, El Salvador, Paraguay an 1 Uruguay did not impose restrictions despite he< vy inflows of foreign currency. Nor did Argentina, which preferred to maintain the completely open system it had maintained since the start of the decade.

The real effective exchange rati s for exports -calculated on the basis of a baskel of currencies of the country's main trading partr ers- declined in 1994 in eight countries of the region (Brazil, Chile, Colombia, Ecuador, III Salvador, Guatemala, Nicaragua and Peru) ii comparison with the average level the year befe re. In another three (Argentina, Paraguay and Uruguay), the real exchange rate declined in relation to the

' For the method of calculating real exchange rates, see note a/ in table II-4.

dollar but rose or remained stable in relation to a basket of currencies. Another six countries (Bolivia, Costa Rica, the Dominican Republic, Honduras, Mexico and Venezuela) recorded increases in 1994 in the real exchange rate, including the rate in relation to the dollar (see table II-4).

In six countries (Brazil, Chile, Ecuador, El Salvador, Nicaragua and Peru) the real appreciation of the currency coincided with a slow-down in inflation, while another five (Argentina, Bolivia, Nicaragua, Paraguay and Uruguay) experienced declining inflation accompanied by real stability or depreciation of the national currency. In Costa Rica, Honduras and Venezuela, real depreciation coincided with a resurgence of inflation, while the Dominican Republic also experienced a surge of inflation despite a stable real exchange rate.

a) **Real appreciation in most countries**

The countries whose real exchange rates went down against a basket of currencies or the dollar received a heavy influx of capital from abroad, enabling them not only to cover easily the demand for foreign exchange but also to increase substantially their international reserves. There were marked differences, however, in the relative size of the flows. In some countries, notably Brazil, Chile, Colombia and Peru, external capital flows were so heavy that they made it very difficult for the countries to meet to their exchange rate and monetary targets. Argentina experienced considerable flows, but international reserves increased only moderately because of the large current account deficit.

The countries in this category had diverse exchange rate systems, including a fixed exchange rate system, systems with various degrees of central bank intervention, and a floating exchange rate system -the latter applied only for relatively short periods, however. Argentina pursued a fixed exchange rate policy in accordance with the Convertibility Act, which provided that the central bank must maintain reserves equal to the monetary base. At the other extreme, Ecuador had allowed the sucre to float beginning in 1993, and this had the effect of accentuating appreciation. In 19i»5, therefore, it established an exchange rate bani.

Most of the countries in ;his category, however, followed a policy o:: central bank intervention in the foreign exchange market to achieve a rate of exchange that vould stimulate exports. Some countries also set exchange rate bands within which the currency was allowed to float more or less freely, with intei vention to firm prices when the rate reached the limits of the band. In some cases the bands could be shifted in accordance with stipulated criteria, such as trends in domestic and internal ional inflation rates. Results varied widely; some countries managed to approximate the targets set by the monetary authorities, while others remained fairly far off target.

Brazil made major changes in its foreign exchange policy. To June 1994, it had an intervention system like that desci ibed above; the exchange rate was adjusted daily on the basis of domestic inflation, with central bank intervention when necessary. With the introduction of the new currency, the country switched to a floating exchange rate system. It had previously been established that one real (the new unit of currency) would equal one dollar. However, when the central bank, in a change from its normal practice, withdrew from the foreign exchange market as of 1 July, the result was a strong appreciation ol the nominal exchange rate. In 1995, the system was again changed because of a deteriorating trade balance and a drastic drop in net capital in! lows. Rotation bands were established and restrictions were placed on imports of some products, particularly consumer durables.

In Chile, the gradual, persistent appreciation of the peso dominated the monetary and exchange picture from the start if 1994. While the expansion of the money supply accelerated, primarily because of foreign exch ange purchases by the central bank to support the flotation band, the real exchange rate continued to fall. In order to offset the monetary impact of the increase in reserves, the central bank resorted to very costly open market operations. At the end of November 1994, as the situation was beconing untenable, the issuing authority changed its foreign exchange policy and shifted the flotation band

Table II-4

LATIN AMERICA AND THE CARIBBEAN: REAL EFFECTIVE EXCHANGE RATES FOR EXPORTS [a]

(Based on consumer price indexes)

Country	1978-1978	1979-1981	1982-1985	1986	1987	1988	1989	1990	1991	1992	1993	1994b
Argentina	102.7	68.2	99.5	100.2	122.4	129.7	143.1	100.0	83.3	77.5	74.4	78.0
Bolivia	69.7	65.5	53.3	67.9	69.8	74.1	71.9	100.0	108.3	116.3	120.0	127.8
Brazil	100.1	123.4	135.0	160.7	156.8	143.2	108.4	100.0	118.5	127.7	115.4	91.0
Chile	58.6	50.1	57.5	88.4	96.3	102.0	96.4	100.0	98.9	95.3	96.6	95.5
Colombia	54.1	51.1	50.9	77.0	85.2	86.5	88.8	100.0	101.0	90.0	87.0	75.3
Costa Rica	61.7	79.7	95.5	95.7	99.6	104.0	98.0	100.0	108.3	103.0	100.7	101.3
Ecuador	47.4	47.0	54.8	68.7	78.8	92.3	94.6	100.0	95.2	94.7	84.0	78.4
El Salvador	151.2	134.8	91.8	117.9	99.7	86.9	82.8	100.0	98.4	98.2	87.4	82.8
Guatemala	55.7	54.9	51.5	65.2	84.1	85.0	85.4	100.0	87.9	87.0	88.2	84.6
Haiti [c]	86.7	82.4	70.7	75.0	88.2	93.1	96.4	100.0	92.8	96.2	110.2	
Honduras	70.6	66.4	55.3	56.6	60.3	60.4	56.1	100.0	107.9	102.2	112.6	1253
Mexico	89.0	76.4	100.5	130.4	135.2	110.0	103.2	100.0	91.1	84.1	79.8	82.1
Nicaragua	278.0	239.3	104.0	24.9	3.1	125.4	150.0	100.0	104.6	104.9	107.0	103.8
Paraguay [e]	70.4	52.4	68.0	86.2	93.1	96.5	101.9	100.0	86.9	90.6	92.2	97.4
Peru	252.3	218.4	198.3	208.1	189.8	195.8	122.1	100.0	82.1	80.9	83.3	87.2
Dominican Republic	87.8	85.9	108.6	105.2	130.2	151.0	109.2	100.0	100.6	101.3	96.8	96.2
Uruguay	84.7	62.1	69.9	78.1	80.6	86.7	86.3	100.0	88.1	84.1	74.2	74.7
Venezuela	50.9	46.1	47.2	62.7	83.9	81.2	96.1	100.0	93.9	88.5	88.9	94.2

Source: ECLAC, on the basis of figures provided by the International Monetary Fund (IMF).

[a] Corresponds to the average of the indexes of the (main official) real exchange rates between each country's currency and the currencies of its main trading partners, weighted by the share of that country's total exports represented by e uports to each of the trading partners. The weightings are averages for the period 1989-1992. For further information on the nethodology and sources used, see ECLAC, *Economic Survey of Latin America, 1981* (E/CEPAL/G.1248), Santiago, Chile, 198: . United Nations publication, Sales No. E.83.II.G.2. Preliminary figures. [c] From 1987 on the commercial exchan; ;e rate was used. The exchange rates used were the following: To July 1982, the mean of the average buying and selling rates is reported to the Bank of Mexico by the main commercial banks; August to November 1982, the preferential rate for essent al imports; after November 1982, the mean of the buying and selling rates on the regulated market. [e] The unregulated or j. arallel exchange rate was used.

downward by 10%, causing a nominal appreciation.

Colombia introduced an exchange rate band system in January 1994, but the tendency towards real appreciation persisted throughout the year, as in 1992 and 1993, due to heavy foreign capital flows. Despite restrictions on entering capital, the foreign currency supply remained high. Because of the difficulties encountered in maintaining the exchange rate and the high cost of sterilization, the exchange rate band was shifted downward, and the result was significant real appreciation.

Peru maintained its floating exchange rate system, but a strong influx of foreign currency obliged the central reserve bank to tuy up a great deal of it. By this means it succeeded in stabilizing the real effective rate of exchange over the course of 1994, althougi the annual average was lower than in 19')3. Bolivia, Ecuador, El Salvador, Guatemala, Paraguay and Uruguay also had intervention systems, but some of these countries failed to meet the targets set by the authorities.

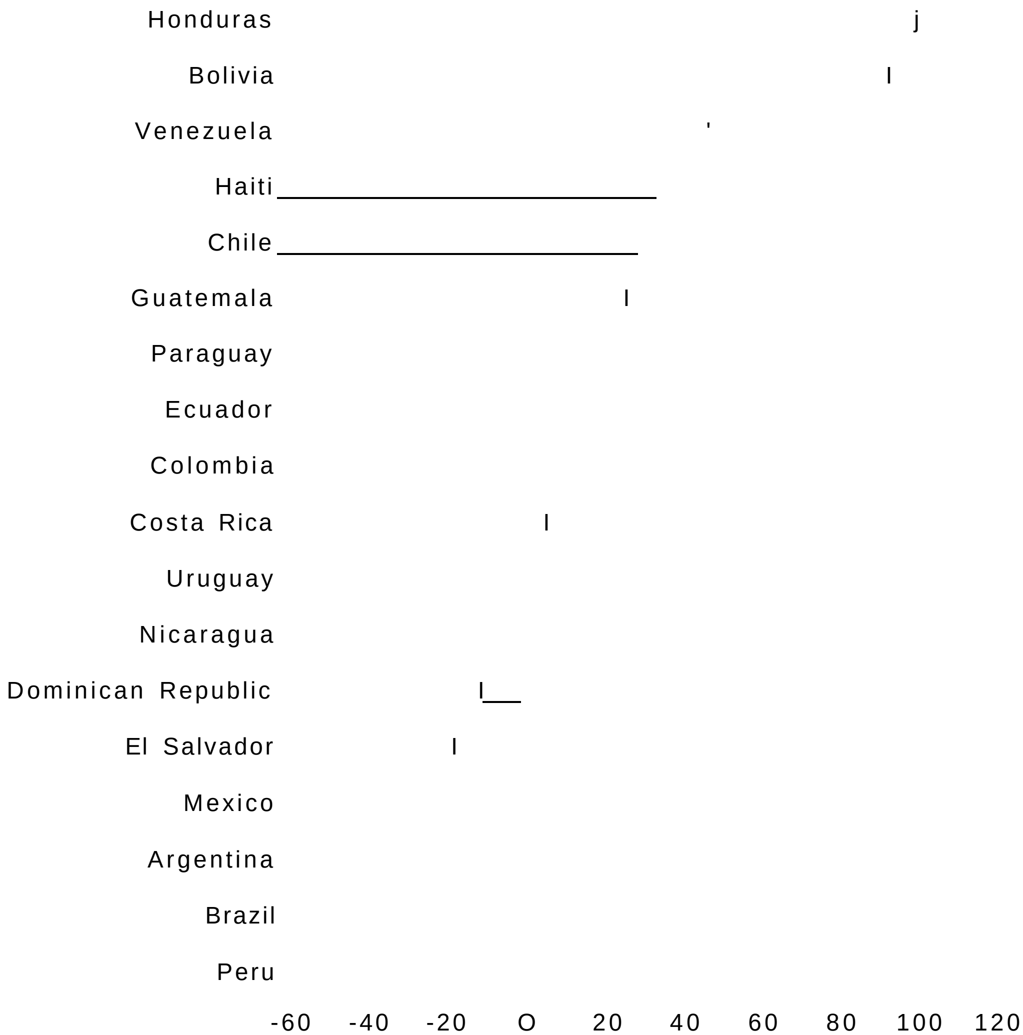
b) Depreciation in a smaller number of countries

In the six countries with a rising r ;al exchange rate, the process varied a great deal, depending

Figure II-4

LATIN AMERICA AND THE CARIBBEAN: REAL EFFECTIVE EXCHANGE RATE INDEXES

(Percentages variation in 1994 with respect to average for 1980-1990)



Source: ECLAC, based on figures from the International Monetary Fund.
a Indexes of the real effective exchange rate for exports.
b The consumer price index was used for all countries.

on the factors responsible for the depreciation of their respective currencies. Haiti, Honduras and Venezuela had been encountering balance-of-payments problems for two years or more, while in Costa Rica, Mexico and the Dominican Republic the imbalances had developed more recently. In general, these countries adopted adjustment me isures to correct the imbalance in their external accounts and fiscal position, so far with scant success.

All the countries in this jroup suffered heavy losses of international re serves because of their large current account deficits; Venezuela and the Dominican Republic also experienced a net outflow of capital. The case of Mexico was unusual; financial flows from abroad were extremely high throughout most of 1994, but dried up after the crisis in December, so that the country wound up the year with a significant net outflow. In Costa Rica, capital continued to flow into the country, but in declining amounts. The situation in Honduras was unique in thatbothreservesandcapitalflows increased, but the reason for it was the delay in external debt service payments.

Moreover, the exchange policies of the countries in question changed during 1994. The most striking example was afforded by Mexico, which had been pursuing a fixed-rate policy with a band of 10% and radically changed its system towards the end of 1994, so that the Bank of Mexico withdrew from the foreign exchange market. The exchange rate thereupon rose rapidly to nearly eight new pesos in a highly volatile market. It later declined and levelled off at six pesos to the dollar, with some fluctuation.

In Venezuela, foreign exchange policy underwent major changes in this as in previous years. The political and economic instability experienced in 1992 was followed by an acute banking crisis, which generated serious imbalances in the money and foreign exchange markets. The central bank maintained its policy of mini-devaluations, but was unable by that approach to avoid a loss of international reserves, so that it was forced tc devalue more drastically. As this measure ilso failed to calm the markets, the currency suffered an abrupt depreciation at the end o f the first half, which induced the Government to adopt a system of exchange controls.

In the other countries in ihis category, changes in exchange policy were minor. Costa Rica continued its managed float of the colón and by postponing a more drastic devaluation brought about some overvaluation of the national currency, and this in turn led to a substantial loss of international reserves. In Honduras, in an attempt to slow the climb of the exchange rate, the central bank at mid-year unified the interbank market and instituted a foreign-exchange auction systsm, with the result that the real exchange rate for 1994 was higher than the year before. In tie Dominican Republic, the rate of exchange remained fixed during the first eight months of 1994; this situation seriously eroded international reserves, created expectations of a devaluation and led to capital flight. Early in September the monetary authorities ordered a 5% devaluation as part of a package of adjustment measures.

4. Monetary policy

The countries of the region in 1994 in general continued to follow the prudent monetary policies initiated in previous years. Room for manoeuvre became narrower due to a combination of internal and external factors. Real domestic interest rates in the local currency remained very high in most countries and in some rose higher (see table II-5).

A number of countries experienced increasing difficulty in controlling the expansion of aggregate demand, primarily as a result of plentiful flows of external capital, particular short-term capital. This situation was conducive to a substantial increase in the money supply resulting from a heavy build-up of reserves. Various measures were taken to deal with the problem, including regulations restricting the influx of short-tern capital and operations to sterilize excess liquidity.

Other countries, meanwhile, were confronted with reduced external capital flows, large fiscal deficits and serious banking crises. Faced with these situations, a number of the m resorted to monetary creation to meet their more pressing needs. This seriously reduced the s :ope of action of monetary policy, especially since these countries experienced a significant contraction in the demand for money as a result of economic crisis and an acceleration of inflation.

Some parts of the region exhibited more positive trends, such as the increased demand for money in countries that succeeded in consolidating their stabilization programmes, following periods of capital flight. The increase in the demand for money made monetary management easier by reducing the need to absorb excess liquidity, thereby forcing interest rates up. The new state of affairs allowed for greater collection of seigniorage and an increase in revenues derived from the inflation tax. A few years back this was an important phenomenon in Bolivia and later in Argentina. In 1994, Brazil and Peru achieved significant remonetization of their economies through progress in their respective stabilization programmes.

Latin American countries can be classified into three categories based on the orientation of their monetary policy in 1994. The first category comprises eight countries that followed a passive monetary policy; the second consists of four that adopted a restrictive policy; the third covers seven countries that pursued monetary policies with an expansive tendency. The countries in each categories are not alike in all respects, and in some cases it is debatable whether a country should be put into one category or another; a given country, for example, may have followed a basically passive monetary policy, but nevertheless applied some restrictive measures.

a) **Passive monetary policies**

A characteristic common to all the countries in this category is that they pursued a managed exchange rate policy. Some maintained a fixed exchange rate, while others allowed the rate to crawl according to certain criteria. The group includes some countries that adopted exchange rate bands, but since during 1994 their exchange rates stayed at the bottom of the band, in effect what they was had a fixed-rate regime. In general, this group of countries had a sound fiscal position, although in a number of cases a deficit was financed with external resources. Despite these basic similarities, their policies differed in detail.

At one extreme are the countries that pursued a completely passive monetary policy. One example is Argentina, whose policy is dictated by its convertibility system. There were no drastic swings in 1994, and the expansion in the money supply was relatively modest, reflecting the moderate increase in international reserves. Because of the crisis at the end of 1994, the financial situation became shîky, primarily because of solvency and liquidity problems in the banking system. The country had to resort to a credit package put together *by* international financial organizations and priva :e domestic and foreign banks in order to create a fund guaranteeing the deposits of troubled banks. Despite these measures, monetary policy remained clearly passive. Bank interest rates rose, through relatively little hroughout the course of the year until the crisis riit at the end of December. Thereafter, they rose rapidly and also displayed great volatility.

In Nicaragua, the stock of noney was an endogenous variable; contributing factors were the financing of the fiscal defic: t with external resources and the elimination c f assistance to State-owned banks. Open market operations were minimal, and the legal reserve proved a relatively ineffective tool, since the commercial banking system had a high level of liquidity and maintained deposits with the central bank that exceeded the legal minimum. In Panama the national currency is tightly pegged to the dollar, leaving no scope for monetary policy.

Five other countries (Bolivii, Ecuador, El Salvador, Paraguay and Uruguay) also had passive monetary policies, because their scope of action was severely limited bj the extensive dollarization of their respective economies. Moreover, they experienced a significant influx of capital from abroad. Reserve requirements and open market operations were used as tools to control the expansion of liquidity but not to great effect. In Uruguay, time deposits in foreign currency increased to the equivalent of nearly 40% of GDP. Most of such deposi ;s, however, are rechannelled abroad as a result of the off-shore banking strategy under which the Uruguayan financial system operates. In Bolivia, monetary policy was severely disrupted in November 1994 by the liquidation of two private banks, and in consequence the ironey supply increased by over US$ 200 ml lion, or 4% of GDP, in just two months. From that point on, Bolivia's situation more closely resembled that of countries pursuing an expansive monetary policy.

Table IIS

LATIN AMERICA AND THE CARIBBEAN: REAL INTEREST RATES '

(Annualized percentages)

	1992				1993				994			
	I	II	III	IV	I	II	III	IV	I	II	ni	V
Argentina												
Deposits	-V5.3	-0.8	-6.1	7.0	4.5	-2.0	5.3	5.7	6.0	3.9	1.2	6.1
Loans	3.1	20.3	9.9	16.6	14.9	8.7	15.8	17.7	19.9	16.6	12.6	19.9
Bolivia												
Deposits	-0.1	14.6	15.8	17.3	12.5	14.1	5.9	14.9	14.1	13.0	5.3	4.6
Loans	5.2	34.3	43.1	48.0	40.5	37.9	37.2	47.8	52.6	44.2	38.1	39.1
Brazil												
Deposits	46.5	8.6	49.7	22.8	6.8	35.3	22.2	27.8	35.5	43.0	7.8	17.8
Loans	290.9	191.9	210.5	93.8	131.8	203.1	92.0	489.4	630.8	399.1	73.0	101.3
Chile												
Deposits	6.4	3.5	-0.8	10.8	4.0	5.7	3.2	8.4	3.1	7.6	5.9	6.0
Loans	12.9	7.8	3.1	16.4	9.5	10.2	8.6	14.7	8.1	12.2	10.7	10.8
Colombia												
Deposits	-10.8	-7.7	8.9	15.1	-9.5	3.0	7.9	9.4	-12.3	5.4	15.7	17.5
Loans	-5.2	3.1	16.0	22.0	-2.8	11.4	17.4	18.7	-4.8	14.7	25.5	24.8
Costa Rica												
Deposits	-11.0	-4.6	7.3	4.4	10.3	-0.7	12.9	6.8	3.0	0.6	-3.7	-7.1
Loans	-0.2	7.2	18.0	14.2	21.2	11.0	25.7	19.5	15.6	13.6	9.5	' 5.2
Ecuador												
Deposits	-3.3	-10.7	-16.7	-0.8	-5.3	-6.9	15.0	1.3	-5.1	3.3	15.2	14.2
Loans	-2.1	-7.2	-11.1	13.6	10.1	1.9	28.0	12.7	3.9	11.6	23.4	21.5
El Salvador												
Deposits	3.8	0.8	-23.4	-6.0	5.0	-2.8	4.6	4.2	0.4	6.1	4.5	5.7
Loans	8.9	4.1	-20.2	-3.0	7.8	0.6	8.8	8.5	4.5	10.8	9.8	11.7
Guatemala												
Deposits	-2.0	-0.4	-3.1	-7.9	5.6	-5.2	3.5	-	-2.2	1.5	-1.8	-4.3
Loans	5.7	7.7	4.7	0.1	16.3	4.9	15.0	11.1	8.5	13.4	11.5	7.5
Honduras												
Deposits	5.9	3.9	10.5	1.7	1.9	-5.6	-2.8	1.9	-9.8	-20.8	-9.4	-12.3
Loans	15.5	12.7	19.7	9.5	10.3	2.1	7.2	12.9	-0.5	-12.3	1.1	-0.3
Mexico												
Deposits, 1 monttó.O		3.5	7.2	5.9	7.0	8.6	6.1	5.8	1.1	8.6	7.6	5.9
Deposits, 3 monttâ.5		3.2	7.5	5.7	6.6	8.7	6.2	5.5	1.3	8.7	7.3	5.6
Panama												
Deposits				4.4				5.5				6.2
Loans				9.1				10.5				9.6
Paraguay												
Deposits					-2.9	8.3	8.8	-1.3	-8.1	14.9	8.0	6.4
Loans					4.9	16.9	17.8	7.9	0.4	25.8	18.3	16.4
Peru												
Deposits	-6.3	4.5	10.1	-0.6	-5.5	1.4	8.7	9.2	3.8	9.2	5.1	5.9
Loans	48.5	57.8	71.5	45.5	37.1	39.0	44.2	44.3	36.0	38.1	28.5	28.8
Uruguay												
Deposits	-2.4	3.6	-12.2	-0.7	-9.9	-16.5	-7.6	-0.7	1.6	-5.6	-6.8	-8.6
Loans	35.5	43.5	26.1	42.7	28.5	17.2	28.7	43.2	45.9	35.3	31.5	29.4
Venezuela												
Deposits					14.8	23.4	12.8	16.7	17.3	-19.0	19.0	-23.3
Loans					24.6	33.7	21.1	19.9	32.8	-6.4	-7.8	-8.1

Source: ECLAC, on the basis of official figures.

[a] Nominal rates deflated by the change in the consumer price index over the relevant period. ' Average valui : for the year.

In Ecuador, nominal interest rates rose in the second half of 1994, which meant that real rates increased considerably, given the rapid decline in inflation. As a result of armed conflict, interest rates rose abruptly in early 1995 to extremely high levels and thereafter declined slowly. In Bolivia and Paraguay, interest rates remained high, but were somewhat lower in El Salvador. In Uruguay, real interest rates on deposits were negative, because of the broad spread between the domestic inflation rate and the considerably lower pace of devaluation. Interest rates on loans, however, remained very high.

b) **Restrictive monetary policies**

Four countries followed a restrictive monetary policy, made more difficult by a heavy influx of capital. The authorities attempted through a variety of measures, primarily open market operations and increases in the reserve requirement, to moderate the expansion of domestic demand. The restraining actions did not have the desired effect, however; domestic demand continued to expand in these countries, Chile excepted, and the exchange rate appreciated. During the course of the year, some countries in this group made their monetary policy more flexible, which tended to push them into the expansive policy category.

Brazil received heavy flows of external capital in the first half of 1994, but their impact on liquidity was cushioned by a strict monetary policy. Interest rates rose considerably, partially in response to the greater volatility induced by the already rapid pace of inflation associated with a generalized system of indexation. As a result, real interest rates remained, on average, around 4% per month. Another factor that helped to reduce the impact of external flows was the improved fiscal performance, reflected in a larger primary surplus and a lower the operating deficit. With the introduction of the new currency in July, a monetary anchor was established and upper limits were set for money creation to March 1995. Those limits were quickly exceeded, however, in part because of the remonetization of the economy made possible by declining inflation and because rf the liquidity problems encountered in some sectors of economic activity.

Colombia, whose economy went through a process of adjustment some yesrs earlier, also had to struggle with the complex problems generated by an abundant flow of external capital. In order to cushion the impact, restrictions were imposed on the entry of short-term capital. Despite the extra cost these measures implied, however, capial continued to flow in. Sterilization measures were then undertaken, but failed to stem the flow, and the chief effect of the attempt was to make the cost of financing very expensive. The se problems led to a revaluation of the currency. Moreover, interest rates rose considerably as a result of the open market operations undertaken to control liquidity.

In Chile, monetary policy had a greater restraining effect than in the two previous cases. In 1994, strenuous adjustment efforts continued to be directed towards reducing the rate of inflation and slowing the grow h of spending, aims that were facilitated by the public sector accounting surplus. The adjustment measures had been introduced in November 1992, when the central bank increased the rea I interest rate on its floating rate notes to 6.5%. In *z* ddition, reserve requirements had been set for short-term capital flows and external financing. These measures succeeded in reducing the growth in domestic demand, enabling Chile to achiev e its goals more effectively than other Latin American countries. A contributing factor may have been the high level of indebtedness of the public sector, which made it very sensitive to the increase in interest rates.

In November, since inflation was on the decline, spending had been curbed and the prospects in the external sector were good, the adjustment measures were lifted, as reflected by a reduction in the short-term interest rate on central bank floating rate notes. Ity the end of the month, however, the pressure exerted by the strong increase in international reserves, resulting in a significant expansian in the money supply, forced a downward shift in the exchange rate band. Through this exchange rate adjustment, the central bank gave itself greater room for manoeuvre in its efforts to control monetary aggregates.

Peru applied a restrictive monetary policy during the first half of 1994, but shifted to a more expansive policy in the second half. Until mid-year, the monetary impact of the heavy influx of capital from abroad was sterilized through deposits by the public sector and the Banco de la Nación with the central bank; thanks to these measures, the money supply expanded only moderately in real terms. In the second half, the impetus of domestic demand and a marked slow-down in prices created positive expectations and enhanced the public's willingness to hold real money balances. The monetary authority opted for a more flexible policy, particularly in relation to public sector deposits, and the result was an acceleration in the pace of monetary expansion. This process of remonetization -the demand for money had fallen to extremely low levels as a result of the runaway inflation of earlier years- allowed the stock of money to keep pace with the considerable increase in transactions without affecting domestic prices. Interest rates in national currency fell as inflation declined but remained quite high in real terms.

c) **Expansive monetary policies**

Expansive monetary policy in some countries was the outgrowth of a political situation of some complexity; this was particularly the case in Mexico and to a lesser extent in Guatemala and the Dominican Republic. Brazil also could be put into this category; its monetary policy, though restrictive during the first half of the year, turned clearly expansive in the second half. The expansive category also includes countries with large fiscal deficits, and some in the latter group also had to allocate substantial sums for financial assistance to counter banking crises. Moreover, these additional needs could not be financed with external resources, because the countries in question were experiencing a sharp contraction in external capital flows. Under these circumstances, the authorities chose to meet the demand chiefly through money creation, since conditions made it extremely difficult to implement an adjustment plan. Real and in some cases even nominal interest rates declined. In consequence, inflation accelerated and currencies depreciated.

In Mexico, the thrust of monetary policy changed radically. During 1994, a number of factors impeded the conduct of monetary and credit policy and contributed toward the high volatility of the local financial markets. Following the drop in internatioral reserves in the second quarter, the Bank of Mexico, acting on the assumption that the situation was temporary, adopted an expansive monetary policy in order to prevent an excessive rise in interest rates and to stimulate econc mic recovery. As a result, the monetary base expanded 13% in real terms, despite a considerable decline in international reserves. The strong < xpansion was unsustainable under a fixed exchange rate regime. These factors triggered a foreign exchange crisis towards the end of December. In the face of this situation, the Government adopted a drastic adjustment programme, involving a return to a strict monetary policy (high interest rates and limits on th< expansion of credit), accompanied by fiscal adjustment; these measures were supported by heavj international financial assistance. Real interest rates declined in the second half of 1994, after reaching their highest level since 1990 in the second quarter. Impelled by fears of devaluation generated by the outbreak of political crisis, interest rates began to shoot up in April, in a reversal of tie downward trend recorded since the end of 195 2. Moreover, the authorities were promoting th<¡ purchase of *Tesobonos*, bonds indexed to the **e** «change rate, which to a great extent displaced peso-denominated government securities. However, with the crisis that hit at the end of] 994, nominal interest rates in pesos began to mo int rapidly to extremely high levels, far outstripping the stepped-up pace of inflation.

In Guatemala, monetary policy was also expansive; reserve requirements were reduced and open market operations suspended with the aim of lowering interest rates. In the Dominican Republic, in contrast to previous years, monetary policy was shaped by the financing required to cover the fiscal deficit and to meet the needs of the private sector, and this orientation resulted in new inflationary pressures and a loss of confidence in the national currency. From September on, however, monetary policy became contractionary once again, particularly through the mechanism of the sale of central bank securities.

In Brazil, beginning in July monetary policy shifted from the restrictive course it had followed during the first half of 1994. The change was chiefly due to the problems faced by the official banking system. Most of the public sector banks were have problems adapting to the economy's new mode of operation based on much lower inflation rates. In the second half, the central bank allocated an amount equivalent to over 2% of output in financial assistance to government banks. The impact of this outlay was offset by the increased demand for money. Another factor that helped to restrain the expansion of the monetary base was the sharp drop in the flows of external capital that had complicated the conduct of monetary policy in the first half. Moreover, strict measures were adopted to control the strong growth in the monetary aggregates and in domestic demand, much of which was directed towards imports. The authorities pushed real interest rates up, imposed restrictions on credit and raised reserve requirements. These measures were tightened further in 1995 in response to the deficit that began to develop in the trade balance beginning in November 1994.

In Venezuela, the actions of the central bank were determined by the overriding need to deal with the financial crisis by providing aid to banks in difficulty; this entailed tolerating a considerable expansion of the monetary base and easing up on reserve requirements. As a result, despite the drop in international reserves and recourse to open market operations in an attempt to drain off excess liquidity, the money supply increased by over 25% in real terms. In the widespread banking crisis, the trend of interest rates became less importanl as financial transactions drastically declined. Most notably, net lending to the private sector declined as the economy experienced the recessive effects of the situation just described, and this in turn resulted in a steady decline in nominal inte rest rates in the second half.

In Costa Rica the economy became further dollarized, and long-term deposits were increasingly converted into demand deposits, while the monetary base expanded over 10% in real terms despite a drop in international reserves. The expansion was further augmented by the currency that went into circulation as a result of the failure of the Banco Anglo-Csstarricense. In order to control monetary expans ion, the sale of stabilization bonds was stepped up and the reserve requirement ratio was raised. Despite the sale of bonds and the implementation of measures to absorb excess liquidity, the nominal interest rate did not increase, <nd this, given accelerated inflation, meant that real interest rates declined. Interest rates on deposits were actually negative.

In Honduras, the money supply expanded 12% in real terms to meet the needs associated with the energy crisis and the losses of the central bank. The reserve requirement was raised in order to moderate the increase in liquidity. As inflation picked up, real interest rates declined and were ultimately negative. Haiti again had to resort to money creation to cover its public sector deficit, since the international embargo continued to keep it from obtaining outside financing until nearly the end of 1994.

B. **STRUCTURAL REFORMS**

Structural reforms were undertaken in most Latin American and Caribbean countries in the late 1980s and early 1990s. Their most important aspects were economic liberalization in terms of both trade and financial regulation and privatization of public sector enterprises. These reforms went hand in hand with an effort to redefine the role of the State, which was also reflected in moves to deregulate markets, changes in economic policy aimed at greater neutrality of policy instruments and fewer sectoral and regional incentives, and maintenance of basic macroeconomic equilibria.

In pursuit of macroeconomic equilibria, reforms were introduced in the sirea of taxes in order to increase fiscal revenues and put them on a sounder footing; in the area of administration and spending in order to reduce costs, streamline government administration and make it more efficient; and in the area of public sector enterprises, in order to make profit maximization part of management strategy and thus achieve positive balances.

Although the reforms instituted by the various countries were similar in many respects, the process was not uniform throughout the region. There were some significant differences in terms of the contexts in which the refor ns took place, the ideologies guiding governments and politicians, the thoroughness w th which the reforms were implemented, and the progress, setbacks and interruptions experienced. In one way or another, however, by the mid-1990s almost all the countries of the regi MI were in the process of reform.

1. **Trade reform**

Major progress was made in the first half of the 1990s in the direction of trade liberalization. Countries such as Argentina, Brazil, Colombia, Mexico and Peru accelerated the process by eliminating bans, quotas and advance permits on imports. There were also sharp cuts in tariff rates and reductions in the rate spread. In some countries -Peru recently and Bolivia some years earlier- short-term targets were set for arriving at a single, uniform tariff. This will bring them to the stage reached by Chile in the second half of the 1970s.

Since the timetables established in previous years for reducing import tariffs were generally adhered to, 1994 saw only minor adjustments relating to specific activities. Tariffs protecting sectors badly hit by external competition, for example, were raised. This was the case in Mexico, where restrictions were placed on imports entering under unfair trade terms and hurting the shoe, garment and tool industries and producers of some intermediate chemical products.

In other countries, tariffs were reduced even sooner than the timetable called for on products selling for high prices domestically because of a lack of competition. This occurred in Brazil, but the measure was short-lived; tariffs were raised again as the trade balance deteriorated in 1995. Costa Rica and El Salvador, on the other hand, lowered tariffs in 1994 in order to bring themselves into line with the Central American common external tariff. The situation in Venezuela ran counter to the rend, as the financial crisis that arose in 19Í6 led to the establishment of a system of exchange controls in mid 1994 that in effect negated the trade liberalization measures introduced during 1989-1990.

The more liberal trade policy of the 1990s was also reflected in the elimination of tax and credit incentives and other types of subsidies for exports. This was the case in Argentina, Brazil, Colombia, Costa Rica, Mexico and Peru, all countries that had pursued sectoral export promotion policies during the previous decade.

Some actions, however, even if limited, were taken in 1994 to mitigate the impact of the decline in the real exchange rate on the profits of the export sector. In Argentina, for example, the authorities decided to reduce employer contributions to the social security system and to lower or eliminate a number of minor taxes in order to reduce the cost of activities exposed to foreign competition. Nicaragua was able to take advantage of a climate of monetary and foreign exchange stability to make progress in promoting exports through a campaign to encourage greater use of the Caribbean Basin Initia :ive and the European Union's generalized system of preferences.

2. **Financial reform and the capital market**

Starting early in the 1990s, some countries that had held back in the previous decade began the process of deregulating their banking systems and liberalizing their capital maikets. These reforms at first were accompanied by a strong influx of external capital, but flows dropped off sharply in 1994.

The measures adopted included deregulating of capital markets and bank credit, liberalizing interest rates and foreign exchange markets, and eliminating obstacles to foreign investment. Some countries, notably Argentina, Mexico and Peru, implemented this set of measures practically in full. Colombia and Costa Rica, on the other hand, maintained some restrictions on foreign exchange and on deposits in foreign currency at banks, or continued to reinforce the official banking system. All these countries also tightened the regulations on their financial systems in order to avoid another crisis like the one in the early 1980s.

While Chile eliminated som<; restrictions on external capital flows, unlike Peru, Mexico and Argentina it adhered to a policy of intervening in the foreign exchange market and sterilizing effects on the money supply in order to avoid the sharp drop in the real rate of exchange experienced in other countries.

3. **Public sector reforms**

Public sector reforms have been in progress since the middle of the past decade, but have gained momentum in the 1990s. The changes have involved primarily tax reform, privatization of public sector enterprises and restructuring of social security systems.

a) **Tax reforms**

Initially, tax reforms involved simplifying the tax structure, applying value-added tax across the board and expanding the tax base. More recently they have focused on enhancing the institutional capacity of both the tax collection and customs offices. Policies have aimed at streamlining and decentralizing organizational structure, training personnel and clamping down on tax evasion by developing computerized data systems.

In nine countries (Argentina, Brazil, Chile, Ecuador, El Salvador, Honduras, Mexico, Nicaragua and Venezuela) a number of tax reform measures passed in 1993 or 1994 went into effect, in some cases as a supplement to previous reforms. In nearly all these countries the reforms were intended to correct the imbalance in public finances, although in some cases there was also an emphasis on simplifying the tax system. Countries resorted to a variety of measures; they raised tax rates (value-added tax, or VAT, sales tax, fuel taxes, taxes on financial transactions), created new taxes, broadened the tax base, withheld taxes on income generated by certain activities and eliminated or reduced exemptions.

The most sweeping reforms were those introduced by Brazil, Ecuador, Honduras and Venezuela. Brazil approved *i* constitutional amendment that cut back on mandatory appropriations of taxes and social security contributions. In addition, on 1 January 1994 a tax on debit balances on curr;nt accounts at banks went into effect for one year only. Moreover, the volume of social security contributions (CONFINS) recovered from the depressed levels in previous years due to court litigation. After Congress rejected a proposal to raise the VAT rate (from 10% to 18%), Ecuador opted for a sharp increase in fuel taxes, so that final domestic pri :es of fuel were higher than international prices for the first time since the country became an oil exporter. In Honduras, tax reform involved higher rates for some taxes, creation of new taxes and expansion of the tax base; among other things, a 1% tax on net assets of companies was introduced, and the sales tax base was broadened. In Venezuela, tie income tax system was revised; VAT, introduced the previous year but only on the wholesale level, was replaced by a tax on luxuries and wholesale sales; finally, a new tax was created on bank debit balances.

Along with reforms aimed at raising revenue, five countries (Argentina, Costa Rica, El Salvador, Mexico and Uruguay) introduced other measures essentially involving tax reductions (lowering rates, eliminating taxes or allowing exemptions) with the aim ol improving the allocation of resources, encouraging certain kinds of activities or simply alleviating the tax burden on specific sectors.

Tax reforms in Chile entailed both increasing revenues and reducing taxes. The tax reforms of 1990, originally due to expire in December 1993, were extended, but at the same time personal income tax was reduced. In the same vein, tax policy was made more flexible by empowering the Administration to move the VAT rate one per cent up or down depending on macroeconomic conditions.

Finally, equalization funds for major export products, such as copper in Chile and coffee in Colombia, benefited from improved prices on the world market. In other coffee-exporting countries, efforts to create equalization funds or special assessments on external sales of coffee beans encountered mixed success. El Salvador, for example, introduced advance withholding of a portion of the assessment on income generated by coffee sales, and Honduras established various mechanisms to set aside some of the excess profits. In Costa Rica, on the other hand, the attempt failed, because coffee exporters sought and obtained an injunction suspending collection of the tax that was to be levied when the price of coffee exceeded 80 centavos per pound.

In terms of administrative reforms, there has been some progress in recent years in decentralizing management by strengthening regional and local bodies. Except in the case of Brazil, however, the costs and the responsibility for providing services and performing functions have been transferred without the corresponding revenues. The process is therefore still incomplete.

b) **Privatization**

One of the major trends of the 1990s has been a strong move in the direction of privatizing public enterprises. In the previous decade, only Chile undertook substantial privatization, but in the 1990s Argentina, Mexico and Peru have also made great strides in this direction. The process has entailed the sale of a significant portion of public sector assets, including, in the above countries, activities traditionally considered strategic (petroleum and natural gas deposits); utilities (telecommunications, ransportation, railroads, ports and airports); activities related to the exploitation of natural resourc ;s (transport of petroleum and natural gas); and *i* ocial services. At the end of 1994, Peru introduced the system of "citizen participation" whereby Peruvians were offered the opportunity to buy stock in State-owned enterprises, similar to the system of "popular capitalism" instituted in Chile in the 1980s.

In Nicaragua, the programme c f privatization moved ahead rapidly as part of the structural reform process initiated in 1990, Privatization did not bring in revenue for the government, however, since the assets were coiveyed free of charge. The People's National Corporations (CORNAP), the agency in charge of administering and privatizing 351 public sector enterprises, pursued and came close to completing its work in 1994.

In other countries, such as B alivia, Brazil, Colombia, Ecuador, El Salvador, Honduras, Uruguay and Venezuela, the process was slow, generally because of a lack of polit ícal consensus about privatization or a lack of agreement about a programme of reforms. In Bolivia, the legislature made progress, albeit ¡lowly, on the capitalization programme, which was to take effect in mid-1995 with the sale of Empresa Nacional de Electricidad (ENDE), divided into four separate entities. The programme is also supposed to cover the whole of the State-owned petroleum enterprise. In Brazil, privatizations in 1994 were chiefly in the petrocherr ical sector. In Colombia, Banco de Colombia wis sold to the private sector, and concessions for cellular telephone business were awarded In Ecuador, the law on privatization and delivery of public services by the private sector went into effect in 1994; it excluded petroleum-relaied activities, electric power and telecommunications.

El Salvador continued its jirivatization process by finalizing the sale of some of the facilities in the San Bartolo free zone and some of the assets of the Salvadoran Ccffee Institute (INCAFE). In addition, the Salvadoras Institute for Agrarian Change (ISTA) divested i self of some assets as a one-time contribution to the land transfer programme under the peace accords. Moreover, a law was passed on pr vatization of sugar mills and alcohol plants. Costa Rica sold the State-owned enterprise Cementos del Pacífico. In Honduras, as part of the economic stabilization plan, the legislature is working on a programme of reforms that include privatization of the Empresa Hondurena de Telecomunicaciones (HONDUTEL).

In Panama, the State-owned telecommunications enterprise was converted to a mixed-ownership enterprise in 1994 because government resources were insufficient to finance the cost of modernizing it. The new Government has proposed privatizing the rest of the enterprise and part of what is now the Hydraulic Resources and Energy Institute (IRHE). Uruguay and Venezuela, meanwhile, have suspended all or most privatization initiatives.

The concession system is still not widespread in Latin America and the Caribbean, but it is making headway in some countries, particularly with respect to the establishment of a legal framework within which the system can operate effectively. The issue is closely connected with programmes for privatizing public utilities supplying electricity, telecommunications, drinking water and sewer systems. The concession system has been applied primarily in the areas of road construction, cellular telephones, cable television, port services, airports and railroads.

c) **Social security reforms**

There have been major advances in the past few years in social security reform, involving in particular the creation of employee contribution capitalization systems to replace the distribution systems currently prevailing in nearly every country in the region. Chile is the exception, since it undertook a thorough reform early in the 1980s. As the oldest such system, it is also the only one so far to show good results, with the additional advantage that it his been able to generate long-term resources to lie intermediated by the financial system.

Recently Argentina, Colombia and Peru have made some progress in social security reform. After lengthy debate, Argentina adopted a new retirement pension system in *V)94*. Under this system, workers still actively employed could elect either to enrol in the new capitalization system and channel their personal contributions into the newly created private pension funds or to remain in the public distribut on system. The number of individuals who chose the capitalization system grew steadily (after a relatively low initial response) to some 3.5 million by the end of the year. The above pension reform (which took effect in the second half of the year) and reductions in employer contributions led to a decline ir social security funds, which was offset in pert by revenues derived from the system of debt payment facilities for overdue social security contributions.

In Colombia, the social security reforms introduced in 1993 translated into higher social security revenues and helped bring about a surplus in the accounts. In 1994 a new system went into effect whereby workers under 40 years of age could elect to enrol in private pension funds, which competed with the government Social Security Institute.

In Peru, the process of social security reform, initiated in 1993, ran into difficulties because of big losses reported by some fund managers. The situation was due in part to the fact that the number of enrollees had not reached the levels hoped for -because of the high amount of contribution required- and in part to the government's delay in honouring acknowledgement certificates, other factors were the paucity of investment nstruments and the lack of an adequate regulatoiy framework.

C. REGIONAL ECONOMIC INTEGRATION AND INTERNATIONAL COOPERATION AGREEMENTS

In 1994 the movement toward multilateral integration maintained the momentum it had shown since 1990. In addition, new trade agreements concluded between Latin American countries with the aim of liberalizing and fostering mutual interchange lielped to bring about a significant expansion of reciprocal trade and demonstrated the advisability of coordinating macroeconomic policies in order to facilitate closer trade ties.

Progress in the area of economic integration agreements was considerable and contributed to the significant liberalization of reciprocal trade. The North American Free Trade Agreement (NAFTA) between Canada, the United States and Mexico, took effect. The Southern Common Market (MERCOSUR), composed of Argentina, Brazil, Paraguay and Uruguay, also began operating. The countries of the Andean Group made progress in integration, including agreement on a common external tariff, and the Central American Common Market became more tightly knit, again thanks to the adoption of a common external tariff.

At the end of 1994 the MERCOSUR countries (Argentina, Brazil, Paraguay and Uruguay) completed their programme of full tariff elimination. During the year they reached agreement on common external tariff levels and arranged for a customs union to take effect on the first day of 1995. The countries presented lists of exclusions, however, some quite extensive, to be phased out over the next five years. This means that beginning 1 January 2001 the customs union should take full effect; there will be no duties between member countries, and uniform tariffs, ranging from 2% to 20% of the import value, will apply to products purchased from outside the union.

Except for the list of products subject to special treatment during a transition period (of four years for Argentina and Brazil and five for Paraguay and Uruguay), tariffs were eliminated on trade within the group. In addition, the structure of a common external tariff (averaging 14%) was defined; with respect to capital goods, the area of greatest debate, the members agreed on linear convergence towards a common tariff within 6 years on conventional machinery and 11 years for computer and telecommunications products.

Because of the many exceptions, the customs union created is imperfect. Moreover, there are other aspects of the integration process that still need to be dealt with, such as coordination of macroeconomic policies between member countries and some issues concerning the ties members have with other countries or trade zones and the incorporation of new members into the agreement.

The North American Free Trade Agreement between Mexico, Canada anil the United States, for which the ratification i process had been completed in the three countries by the end of 1993, went into effect on 1 January 1994. This forced Mexico to continue its efforts to adapt its institutions to accord better with the agreement. Membership in NAFTA thus entailed tariff reductions and changes in a number of regulatory agencies as part of the process of modernizing the legal framework governing relations between economic agents and their external contacts. Major steps taken by the country included amending the Customs Act, changing the foreign trade regula ions, creating an Advisory Council on International Trade Practices, adopting new provisions regarding rules of origin, becoming party to the Patent Cooperation Treaty, creating th; Institute of Measures and Standards, enacting the Public Investments Act and establishing the Mexican Industrial Property Institute.

The Andean Group also nude progress towards integration through agretments signed by all or some of the members. On 31 January 1995, for example, Colombia, Ecuador and Venezuela agreed on a common external tariff with four tariff levels (5%, 10%, 15% and 20%, except for motor vehicles, which a:e subject to a rate of 40%). The common exterial tariff will take full effect on 31 December :.995, and the exclusions stipulated by the member countries will be eliminated over the course of four years. Peru and Venezuela agreed to extend their preferential tariff arrangement und< r the bilateral trade agreement signed by the two countries in 1992 to an additional 198 Venez jelan and 89 Peruvian products. Some 60% of the tariff preferences reciprocal and relate primarily to textiles and agricultural products. Finally, multilateral negotiations are progressing between the Andean Group and MLRCOSUR.

Apart from the institutionalize! integration processes described above, in recent years there has been a proliferation of bilateral or multilateral agreements between La tin American countries, generally involving tariff reductions in order to promote reciprocal trade. There has also been greater interest shown in international trade and cooperation agreements, as demonstrated by accession to GATT and ratification of the act establishing the World Trade Organization (WTO).

Ecuador took the steps preliminary to joining GATT/WTO in 1995 and undertook bilateral negotiations aimed at strengthening trade ties with Chile, Mexico and the Dominican Republic, among other countries. Towards the end of 1994 Ecuador signed a free trade agreement with Chile providing for a gradual elimination of tariffs.

El Salvador made similar efforts to establish integration agreements with other countries in Latin America (Colombia, Venezuela, Ecuador, the Dominican Republic and Mexico). It has also been seeking an alignment with NAFTA through negotiations together with other Central American countries. Under the General Agreement on Tariffs and Trade (GATT), El Salvador acted expeditiously against practices prejudicial to its trade. In late September, the Textiles Surveillance Body issued a ruling favourable to the country in its appeal against a quota imposed by the United States that would limit Salvadoran exports of shirts made of cotton and synthetic fibres.

Mexico became a member of f. le Organisation for Economic Co-operation and Development (OECD) in May. It also completed negotiations on trade agreements with Costa Rica, Colombia and Venezuela.

Nicaragua initiated talks on free trade agreements with Mexico, Colombia and Venezuela. In Panama, the new Government stepped up the pace of talks on membership in GATT, which at this stage were focused on revisions in trade liberalizado i measures in certain sectors, and this made it difficult to agree on specific limits. In 1994, the Dominican Republic joined the Association of Caribbean States and signed the act establishing the World Trade Organization, although it s renegotiating the status of various agricultural products because of the potential damage 1 he sector might suffer if quantitative restrictions were eliminated. The Government also managed to get for the Dominican Republic the same free zone benefits that Mexico obtained from the United States under the North American Free Trade Agreement (NAFTA).

III. LEVEL OF ACTIVITY, INFLATION AND EMPLOYMENT

1. Growth of GDP and national income

The gross domestic product (GDP) of Latin America and the Caribbean grew by 4.5% in 1994, thereby accelerating the moderate recovery which had begun in 1991. Per capita GDP therefore increased again, this time by 2.6%. However, since the regional GDP for 1994 was only 30% higher than the pre-crisis 1980 figure, per capita GDP was still 2% below its 1980 level. The expansion of GDP was fairly widespread; only four countries registered setbacks in the level of activity. There was also greater consistency in the various countries' growth rates than in previous years. The vast majority of the region's economies marked up growth rates close to the average rate for the region as a whole, while the largest increases were achieved in countries whose levels of activity were recovering from the prolonged recession of the 1980s. The growth registered in 1994 was based mainly on the expansion of external demand, as well as on the buoyancy of investment, which once again was encouraged by a copious inflow of external financing (see table 1-2).

In three countries GDP rose by more than 6%. Peru exhibited the highest growth rate in the region (12.7%), even higher than its 1993 rate (6.5%), and was thus largely able to recover from the recession which it had suffered in the period 1988-1992. Guyana maintained its high rate of the preceding year (8%), thereby carrying forward its recovery for the fourth year running. Argentina again showed substantial growth (7%), thereby rounding out four years of notable expansion and posting a cumulative increase of 34%. Moreover, in 12 countries -Barbados, Bolivia, Brazil, Chile, Colombia, Costa Rica, the Dominican Republic, Ecuador, El Salvador, Panama, Trinidad and Tobago and Uruguay- GDP expanded by between 4% and 6%. Chile maintained its steady pace of expansion for the eleventh year in a row, although its growth rates dipped below the average of 7% for the previous three years. Meanwhile, Colombia, which for many years had shown positive, if occasionally modest growth rates, managed to speed ip the pace of its expansion in the most rece it three-year period. Brazil, which had turned in a poor performance between 1988 and 1992, pushed ahead, in an environment of ins [ability, with the recovery that had begun in li'93, but even so was unable to regain the levels reached in the mid-1980s.

Five other countries (Belije, Jamaica, Mexico, Nicaragua and Paraguay] experienced moderate growth of between 2% am 13%. Mexico was thus able to rebound fron the virtual standstill it had reached in 1993, with a growth rate similar to the average rate for the period 1989-1992. Paraguay, meanwhile, registered a growth rate which, if slightly lower than that of the preceding year, enabled it to continue expanding for the eighth year runnir g. Nicaragua raised its level of activity by 3.2%, following a decade of declines; however, GDP was only two thirds of what it had been in thî three years immediately preceding the crisis (1976-1978). In Belize the growth rate was the lowest in recent years, while Jamaica shoved modest growth, similar to that of the previous three years.

In contrast, the level of activity fell in four countries. In Haiti, the setback reflected the prolonged impact of the recession that had afflicted the country since the outsreak of the political crisis. In Venezuela, meanwhile, the recession that had emerged the year before deepened, following three years of tiigh growth rates. In Honduras GDP contracted, following two years of strong expansion, and in Suriname itdeclinedoncemore.EconomicactivityinCuba continued to be mired in the deep crisis that the country had been experiencing for some years, owing to the collapse of its relations with the now disbanded socialist system; accordingly, GDP was only slightly more than half of what it had been in 1989.

Lastly, while the small countries of the Organization of Western Caribbean States (OWCS) grew moderately (2.9%), by slightly more than the year before, there were wide differences among the members of the group: Antigua and Barbuda had the highest expansion rate (over 5%) and Saint Vincent and the Grenadines the lowest (only 0.4%).

Thanks to the higher pace of growth in 1994, 14 countries, not counting those of owes, had a better showing than in 1993, while another seven countries maintained their growth, although for two of them the rates were somewhat lower than in the previous year; furthermore, only three countries registered a marked deterioration in the level of activity. This stands out in sharp contrast to the preceding year, in which only seven countries had improved their performance in relation to 1992 (see table 1-2).

Even though population growth rates remained fairly high in many countries of the region, the figures for per capita GDP were positive for the most part. In four countries -Argentina, Guyana, Peru and Uruguay- this indicator of well-being climbed by 4% or more, while in another nine -Barbados, Brazil, Chile, Colombia, the Dominican Republic, Ecuador, El Salvador, Panama and Trinidad and Tobago- it showed an improvement of between 2% and just under 4%. In three economies -those of Bolivia, Costa Rica and Mexico- per capita GDP rose only slightly, by between 1% and 2%, while in Guatemala, Jamaica and Paraguay the increase was under 1%. In the remaining six countries per capita GDP decreased.

Given the poor performance of the region's economies during the past decade, per capita GDP in 1994 was higher than in 1980 in only 10 countries: Chile (37%), Jamaica (35%), Belize (31%), Colombia (29%), Uruguay (16%), the Dominican Republic (8%), Panama (5%), Costa Rica (4%) and Argentina (1%), while in Barbados, Ecuador, Mexico and Paraguay, this indicator declined slightly, by around 1 %. At the opposite extrer le, the sharpest downturns in per capita GDP vere in Haiti (-48%), Nicaragua (-41%), Trinidad and Tobago (-32%), Peru (-21%), Venezuela (-17%), Guatemala (-15%) Bolivia (-13%), Suriname (-8%), El Salvador and Honduras (-7%), Guyana (-4%) and Brazil (-3%) (see table 1-3).

In 1994 all sectors showed g eat buoyancy, especially the service sector, which contributed half the GDP growth of the region as a whole, and manufacturing, which contributed a fourth. Furthermore, in 11 of the 21 countries for which information is available, the increase in the level of activity was due mainly to the service sector, while in seven others the largest impetus came from goods-producing sectors. In he remaining three countries, GDP contracted, mainly as a result of a poor performance i i goods trade, although the service sector also had unfavourable results (see table II-l).

The growth in services was more uniform than in manufacturing and especially construction. The largest growth in services occurred in Argentina, Colombia, Costa Rica, El Salvador, Guatemala and Peiu, with growth rates of between 5% and 9%, while drops occurred only in Haiti, Honduras and Venezuela, the only countries in the region whose total GDP declined. In manufacturing, Peru stood out with an increase of 18%, but there were also significant expansions (of 8% and more) in three other countries -Brazil, Ecuador and El Salvador- whil<; declines were seen in the same three recession-stricken countries, as well as in Jamaica, which showed a slight deterioration. In the construction sector the differences were even mon! marked; Peru achieved a notable increase of 35%, and four other countries (Argentina, Colombia, El Salvador and Nicaragua) made gains of over 10%. On the other hand, thsre were also significant contractions, of bet ween 17% and 50%, but only in the countries undergoing recession. Agriculture registered a significant

Table III-1

LATIN AMERICA AND THE CARIBBEAN: GROSS DOMESTIC PRODUCT, BY BRANCHES OF ECONOMIC ACTIVITY, AT MARKET PRICES

(Annual growth rates)

	Agriculture		Mining and quarrying		Manufacturing		Construction		Subtotal goods		Basic services		Other services	
	1993	1994°	1993	1994"	1993	1994[a]	1993	1994[a]	1993	1994[a]	1993	1994[a]	1993	1994[a]
Latin America and the Caribbean	0.2	4.3	2.4	5.4	3.9	4.9	5.3	4.3	3.0	4.8	6.7	S.9	2.4	**3.2**
South America	-0.1	5.3	3.6	5.9	5.5	5.4	6.0	3.7	4.0	5.3	7.9	5.4	3.0	3.3
Argentina	-1.0	1.5	6.0	11.4	4.5	4.1	10.9	14.3	4.5	5.4	8.1	6,9	7.2	7.9
Bolivia	3.4	4.8	6.8	6.3	4.4	4.9	4.0	1.7	4.6	5.1	6.1	5.2	3.2	2.8
Brazil	-1.2	7.5	0.6	4.7	8.0	7.9	5.1	5.9	4.8	7.4	9.6	5 3	1.4	1.3
Chile	1.5	8.1	0.9	2.7	5.1	2.9	14.0	2.0	4.7	3.7	6.7	74	6.0	3.6
Colombia	2.7	2.0	-2.8	0.6	2.3	2.8	7.0	11.8	2.1	3.0	5.1	69	6.2	8.5
Ecuador	-1.7	1.6	5.9	6.8	6.9	9.4	-4.3	5.3	2.8	5.9	4.1	44	2.9	2.4
Guyana	5.9		49.0		3.5		3.5		11.8		6.0		3.0	
Paraguay	5.6	2.4	-1.2	2.0	2.0	1.5	2.7	3.6	4.2	2.2	8.5	82	2.6	3.9
Peru	7.7	13.2	7.8	7.2	7.6	17.8	13.0	34.5	8.4	16.5	5.3	7 0	3.8	8.9
Uruguay	-5.1	4.5	17.8	2.3	-9.0	3.1	17.8	2.4	-5.2	3.5	7.1	6 8	4.7	3.1
Venezuela	-2.7	-3.1	5.5	7.4	-0.7	-4.1	-2.3	-25.7	1.2	-2.8	1.4	-1.2	-1.7	-2.4
Mexico	1.4	2.0	0.9	1.6	-0.8	3.6	2.8	6.4	0.3	3.5	3.5	7.8	0.7	**3.0**
Central America and the Caribbean	0.9	0.9	-9.5	**12.2**	2.9	2.6	7.4	1.9	1.3	2.7	4.8	4.»	3.8	**4.0**
Barbados	-7.1		3.5		-0.4		2.2		-1.4		0.9		1.7	
Costa Rica	2.4	2.6			6.4	¿?	16.5	4.2	5.4	3.5	9.0	7.5	6.1	4.4
El Salvador	-1.4	-2.4	11.3	12.0	8.3	7.9	8.3	10.1	2.4	2.0	9.6	7. i	3.9	5.7
Guatemala	2.1	2.0	10.8	5.3	2.7	2.7	-2.0	-2.0	2.1	2.0	6.4	6.7	5.1	5.1
Haiti	-8.0	-8.2	-25.0	-66.7	-6.3	-26.6	-29.9	-50.4	-9.7	-15.8	-6.7	-42.0	2.4	-3.1
Honduras	1.3	-2.9	3.6	4.7	6.3	-2.0	21.1	-17.2	5.5	-4.1	4.2	3..	8.3	0.0
Jamaica	10.1	7.5	0.3	6.9	-1.8	-0.5	-0.5	-6.3	1.5	2.3	7.1	4."	0.7	9.6
Nicaragua	1.8	11.3	2.7	5.9	0.0	1.0	1.5	11.0	1.0	6.7	-2.0	O.'.i	-1.8	-0.7
Panama	0.6	3.9	19.0	12.0	7.0	4.5	31.5	6.5	9.3	4.8	3.2	6.	4.1	3.3
Dominican Republic	0.7	-1.8	-38.7	92.5	2.2	2.9	10.1	6.6	0.7	5.4	7.5	4.::	3.1	3.3
Trinidad and Tobago	-3.1	12.6	-8.9	5.5	-3.7	8.6	-4.4	7.3	-6.9	6.9	1.6	2.!	1.8	1.2

Source: ECLAC, on the basis of official figures converted into dollars at constant 1980 prices.
[a] Preliminary figures. Excludes Cuba. [c] Includes mining and quarrying.

increase in Peru and decreases in the other three countries mentioned, as well as in El Salvador and the Dominican Republic. Lastly, mining achieved satisfactory results in most of the countries in which it plays an important role. It expanded even in Venezuela, in contrast to the country'sothereconomicactivities.

Net factor payments to the rest of the world diminished slightly, indicating a return to the downward trend seen in the period 1990-1992. As a result of this and of the region's slightly more favourable terms of trade, g :oss national income in 1994 increased more rapidly (5.2%) than gross domestic product, and, in per capita terms, the increase was consider ible (3.3%), higher than in the preceding years. í fone the less, per capita national income was 7% ower than in 1980 (see table III-2).

2. Supply and demand

In 1994 the upturn in the level of activity of the Latin American and Caribbean economies as a group was reflected also in an increase in the total supply and the domestic supply of goods and services. This came in response to a notable reactivation of investment, a sustained expansion of exports and, to a lesser extent, an increase in consumption.

Total supply again expanded significantly at a rate of 5.6%. This rate, the highest since 1981, outstripped the rapid pace of growth of the preceding three years (4.8% on average) and strengthened the recovery hat had begun in 1991 (see table III-2). The volume of the region's imports swelled by nearly 12%, a rate higher than in 1993, but significantly lower

Table III-2

LATIN AMERICA AND THE CARIBBEAN: TOTAL SUPPLY, DOMESTIC DEMAND AND GROSS NATIONAL INCOME"

(Indexes and growth rates)

	Indexes (1980 = 100)			Growth rates					Cumulative variation	
	1992	1993	1994[b]	1990	1991	1992	1993	1994[b]	j ^ ¿ "	j ^ ¿
1. Total supply (2+3)	121.6	126.7	133.8	1.2	5.0	5.2	4.1	5.6	10.1	21.5
2. Gross domestic product at market prices	120.3	124.2	129.9	0.3	3.6	3.1	3.3	4.5	12.7	15.3
3. Imports of goods and services	130.1	142.2	158.8	8.2	15.3	20.0	9.3	11.7	-6.0	68.9
4. Exports of goods and services	184.7	197.6	213.7	5.1	4.5	6.6	7.0	8.1	65.8	28.9
5. Domestic availability of goods and services (2 + 3 - 4) = domestic demand (6 + 7)	112.9	116.9	122.8	0.3	5.1	4.9	3.5	Í.0	2.4	19.9
6. Final consumption expenditure[c]	120.1	123.4	128.2	0.9	4.7	3.9	2.7	*4.0*	10.4	16.2
7. Gross fixed capital formation	89.2	95.3	104.6	-2.5	6.8	9.9	6.9	S .7	-24.0	37.5
8. Net factor payments to rest of world	145.8	155.5	154.5	-13.9	-5.7	-3.9	6.6	*-V.6*	60.9	-4.0
9. Real gross national income (2 - 8)	113.7	116.5	122.6	0.9	3.5	3.3	2.5	Í.2	6.2	15.4

Source: ECLAC, on the basis of official figures converted into dollars at constant 1980 prices.

[a] Nineteen countries. Preliminary figures. [c] Includes variation in stocks. Includes unrequited private transfers and terms-of-trade effect.

Table III-3

LATIN AMERICA AND THE CARIBBEAN: COMPONENTS OF TOTAL DEMAND

(Annual growth rates)

	Consumption				Gross investment				Domestic demand		Exports		Total demand	
	Private		Government		Fixed		Demand							
	1993	1994°	1993	1994[a]	1993	1994[a]	1993	1994[a]	1993	1994[a]	1993	1991[a]	1993	1994[a]
Latin America and the Caribbean	3.3	4.3	2.8	**3.2**	6.9	9.7	4.7	**8.5**	3.5	**5.0**	7.0	**8 1**	4.1	5.6
South America	4.6	4.S	3.2	**3.9**	**10.1**	**10.8**	**8.1**	9.2	**5.1**	5.3	7.6	**8 0**	5.6	**5.8**
Argentina	5.4	4.2[C]	d	d	13.7	18.9	13.7	18.9[e]	7.0	7.2	4.9	15 3	6.7	8.2
Bolivia	3.3	3.5	2.5	0.4	5.1	-5.5	-11.9	-39.0	0.7	-3.0	16.8	197	4.4	2.8
Brazil	5.0	6. I[e]	d	d	9.8	18.7	9.8	18.7[e]	5.7	7.9	9.2	56	6.2	7.6
Chile	6.9	3.7	3.3	2.3	17.7	3.5	12.5	1.0	7.9	2.9	4.6	6 7	7.0	4.0
Colombia	4.0	6.4	17.9	16.4	33.2	13.4	26.6	11.7	10.1	8.9	7.4	0,8	9.6	7.4
Ecuador	2.9	4.9	-1.2	-3.8	1.1	5.4	-4.2	11.3	1.0	5.1	4.6	7,9	2.2	6.1
Paraguay	10.7	5.8	5.3	3.8	2.4	4.6	2.3	4.5	8.6	5.4	33.4	3,7	13.6	5.0
Peru	2.2	12.0	3.6	9.2	10.4	36.0	12.3	29.1	4.5	15.6	8.1	15.6	5.2	15.6
Uruguay	6.3	9.0	0.9	4.5	10.3	4.0	7.9	9.9	5.8	8.5	7.0	8.1	6.1	8.4
Venezuela	-0.2	-7.5	-4.6	-4.4	-6.0	-25.4	-18.4	-48.4	-4.7	-14.4	6.6	10.1	-1.6	-7.2
Mexico	-0.5	4.1	2.0	2.5	-1.2	**8.1**	-3.0	7.8	-0.7	4.7	4.9	9.»	0.3	**5.5**
Central America and the Caribbean	2.3	3.2	4.6	3.1	**15.0**	3.9	7.7	2.3	3.6	3.0	9.0	5.5	4.8	3.6
Costa Rica	8.3	6.5	6.0	3.0	22.8	4.0	10.5	2.1	8.5	5.0	13.6	3.)	10.4	4.4
El Salvador	7.0	6.1	1.4	3.0	14.7	12.1	9.4	7.9	6.9	6.1	20.0	11.1	9.4	7.2
Guatemala	5.2	5.2	8.0	4.1	6.5	-1.0	-5.9	0.6	3.5	4.4	6.9	*4 A*	4.0	4.4
Haiti	-4.3	-7.9	1.2	-9.1	-8.5	-56.9	-8.5	-56.9	-4.8	-13.5	11.6	-37.:»	-2.7	-17.0
Honduras	5.9	-1.6	4.9	-5.4	18.5	4.2	17.4	-9.8	8.5	-4.0	-0.1	-i.:i	6.5	-3.5
Nicaragua	-6.8	2.0	-3.3	-3.0	14.5	-0.3	-10.9	12.8	-6.7	2.3	4.1	5.:ï	-4.9	2.8
Panama	1.4	3.1	2.0	5.2	31.6	6.1	24.8	7.3	7.6	4.7	3.2	7.Ü	6.2	5.7
Dominican Republic	-3.9	1.2	7.3	8.2	7.5	6.3	7.3	6.2	-0.4	3.1	11.1	12.11	1.4	4.7

Source: ECLAC, on the basis of official figures converted into dollars at constant 1980 prices.

[a] Preliminary figures. [b] Nineteen countries; figures on private consumption and investment include estimates ir the case of some countries for which data were lacking. [c] Includes variation in stocks. Government consumption is included under private consumption. [e] Does not include variation in stocks.

thanin 1992. This trend was largely attributable to the notable expansion in the volume of imports made by Peru (30%), Brazil (23%), Argentina (20%), Colombia, Ecuador, El Salvador, Mexico and Uruguay (all between 14% and 18%) and, to a lesser extent, Chile, Costa Rica, the Dominican Republic, Guatemala, Panama and Paraguay (between 4% and 9%), while in Nicaragua the increase was slight. The volume of imports decreased in only four countries; the most significant drops were in Haiti (-37%), Venezuela (-29%) and Honduras (-8%), while in Bolivia there was a slight decrease. The increase in tie volume of merchandise imports nearly matched the rise in their value, since unit values did not change significantly. Sharp increases were seen in imports of consumer goods, intermsdiate goods and capital goods, while fuel purcha ses declined, owing to the drop in petroleum prices. The increase in imports of intermediate goods represented just over 50% of the exp ansion in the region's total imports, while capital goods imports accounted for somewhat 1 JSS than one third and consumer goods purchase s one fifth of the total increase.

The volume of exports grew by 8%, which was higher than the mean annual rate for the period 1981-1993, as well as the 1993 figure. In Argentina, Bolivia, the Dominican Republic, El Salvador and Peru, the volume of exports showed significant increases of between 11% and 20%, while in Chile, Mexico, Panama, Uruguay and Venezuela, the increases ranged from 7% to 10%. In Brazil there was a moderate expansion of somewhat below 6%. In contrast, a sharp contraction was seen in Haiti (-37%) and a slight decrease (-1%) in Honduras.

Because the real growth rate for exports was lower than the rate for imports, the domestic supply of goods expanded (5.2%) somewhat more rapidly than GDP. As a result, supply exceeded the 1990 level by 20%, and, in per capita terms, was 11% above that year's figure (see table III-2).

The expansion of domestic demand stemmed from a sharp rise in gross capital formation and, to a lesser extent, in consumption. Fixed investment climbed by 9.5%, thereby continuing the upward trend that had begun in 1991. However, regional investment represented only 18% of GDP, while in the period 1979-1981 this ratio had been somewhat higher than 23%. Consumption rose more quickly than the year before, since it grew by 4% as compared with slightly less than 3% in 1993. Thus, final consumption expenditure was 16% greater than in 1990 in real terms, thereby exceeding the region's population growth rate for the same period.

The growth of the region's GDP in 1994 was solely the result of the buoyancy of domestic demand. Once again there was an outward shift in domestic demand, which, if greater than in the previous year, was smaller than the shifts seen in 1991 and 1992. The volume of exports expanded considerably and thereby contributed to generating an increase in total demand equivalent to 1.8% of GDP, a higher increase than in preceding years. Be that as it may, this effect was more than offset by the channelling of a portion of demand, amounting to 2.1% of regional GDP, to increased impo: is.

Meanwhile, the growth of consumption -especially in the private sector- made a contribution equivalent to over 3 points of GDP to the increase in total demand (somewhat more than in the preceding two years). Despite this improvement, per capita consumption in 1994 was still 1% below its 1980 level as a result of its earlier declines, mainly during the first half of the 1980s. Meanwhile, fixed investment again made a significant posit ve contribution (equivalent to nearly 2% of GDI'), in contrast to its results in the 1980s, when its contribution had clearly been negative in character (see tables III-3 and III-4).

With regard to total demard, the regional trend of rapidly rising investmînt and exports and a slower expansion of private consumption was shared by a good number of individual countries, although the size of t tie contributions made by the various components of demand varied from one country to the next. In fact, domestic demand climbed in 15 of the 19 countries for which information was available, and in seven of them (Argîntina, Brazil, Colombia, El Salvador, Paraguay, Peru and Uruguay), the increases were qui te large, ranging from around 7 to 15 points of GDP. Domestic demand also swelled in Costa Rica, Ecuador, Guatemala, Mexico and Parama (where it increased by between 4% and *5%* of GDP) and in Chile, the Dominican Republic and Nicaragua (around 3 points). In Bolivia and Honduras, meanwhile, domestic demand fell by between 3 and 4 points of GDP, and in Hail i and Venezuela it shrank outright (by over 10%] i.

In nine of the 15 countries in which domestic demand grew, fixed investment increased faster than private consumption, while in the other six the opposite was true. However, the size of the contribution made by fixed investment to GDP growth was comparable to that of private consumption, as that variable's more moderate growth was offset by its sigrificantly higher

[1] This figure includes variations in stocks.

[2] It should be noted this analysis of the contributions made by the different components of demand to chi nges in GDP does not incorporate the impact of variations in the terms of trade, since it is based on accounts reflecting real flows. By the same token, the discussion of variations in each of the components of domestic demand does not reflect the real impact < f changes in relative prices, which have come to be of considerable importance in the countries' recent adjustment processes.

Table III-4

LATIN AMERICA AND THE CARIBBEAN: CONTRIBUTIONS TO GROWTH OF GROSS DOMESTIC PRODUCT, 1994

(Average annual percentages)

	Total demand							Total supply	
	Private consumption expenditure	General government consumption expenditure	Total consumption	Domestic fixed capital formation	Domestic demand	Exports of goods and services	Total	Impôts of gooes and services	Gross domestic product
Latín America and the Caribbean	**3.1**	0.3	3.3	1.7	4.8	1.8	6.6	2.1	4.5
Argentina	3.4	-	3.4	3.6	7.0	2.1	9.1	*2.1*	6.9
Bolivia	2.4	-	2.5	-0.8	-2.8	6.3	3.5	-0.7	4.2
Brazil	4.8	-	4.8	2.6	7.5	1.0	8.5	2.5	5.7
Chile	2.2	0.2	2.4	0.8	2.7	2.3	5.0	0.')	4.1
Colombia	2.9	3.8	6.7	1.9	8.8	0.2	9.0	3.4	5.6
Costa Rica	4.2	0.4	4.6	1.1	5.1	2.2	7.3	3.1)	4.3
Ecuador	2.8	-0.3	2.4	0.8	4.1	3.4	7.4	3.:t	4.2
El Salvador	4.8	0.3	5.1	2.4	6.7	3.2	10.0	5.(1	4.4
Guatemala	4.3	0.4	4.7	-0.1	4.8	0.8	5.6	1.!»	3.8
Haiti	-6.0	-1.4	-7.4	-6.1	-14.2	-6.8	-21.0	-8.Í»	-12.2
Honduras	-1.1	-0.6	-1.7	1.0	-4.4	-0.4	-4.8	-3.)	-1.6
Mexico	2.8	0.3	3.0	1.7	4.7	2.0	6.7	3.::	3.5
Nicaragua	1.6	-0.6	1.0	0.0	2.7	1.3	4.0	0.Í	3.2
Panama	1.7	0.8	2.5	1.8	4.7	3.6	8.3	4.(	4.3
Paraguay	5.3	0.3	5.7	1.0	6.7	1.4	8.1	4.(	3.5
Peru	7.9	0.9	8.8	6.8	15.2	3.5	18.7	6.C	12.7
Dominican Republic	0.8	0.9	1.7	1.4	3.2	2.7	5.8	1.5	4.3
Uruguay	6.4	0.6	7.0	0.5	8.3	2.8	11.2	6.1	5.1
Venezuela	-4.3	-0.5	-4.8	-5.2	-12.2	3.5	-8.7	-5.7	-2.9

Source: ECLAC, on the basis of official figures converted into dollars at constant 1980 prices.

share of total demand. Thus, in 10 of the countries, far more than half the increase in domestic demand came from private consumption; in Argentina and Peru, the two components' contributions were similar, and in Colombia, the Dominican Republic and Panama, most of the increase was generated by investment.

Because of the net effect of an increase in imports and a somewhat more moderate rise in exports, in some countries a portion of the growth in domestic demand was diverted to the external market, and the expansion of GDP was therefore less marked than it would otherwise have been. Even so, in Argentina, Brazil, Colombia, Costa Rica, El Salvador, Panama, Peru and Uruguay the momentum generated by domestic demand was reflected in high growth rates. In Guatemala, Mexico and Paraguay, the CDnsiderable deterioration in these countries' external trade position resulted in very little GDP gowth. On the other hand, the increase in Chile's rade balance and the reduction of deficits in thî Dominican Republic and Nicaragua made it possible for these countries' GDP growth to outdistance the expansion of domestic demand.

Despite the above, in some countries exports continued to make an important contribution to the rise in the level of activity. In Bolivia, Ecuador, El Salvador, Panama and Peru, the expansion of exports contributed between 3 and 6 points of GDP, while in Argentina,] îrazil, Chile, Costa Rica, the Dominican Republic, Mexico, Nicaragua and Uruguay, their contribution amounted to between 1 and 3 points; in the case of Venezuela, this contribution amounted to over 3 points, which helped to offset a large share of the downturn in domestic demand (see table III-4).

Domestic demand shrank only in Haiti (-14 points of GDP), Venezuela (-12 points), Honduras (-4 points) and Bolivia (-3 points). While in all these countries private consumption declined, and this accounts for the bulk of the downturn in domestic demand, in Haiti and Venezuela the drop-off in investment was an equally influential factor. The contraction of domestic demand was counteracted in Haiti and Honduras by the reduction of the trade deficit and, in Venezuela, by the growth of the trade surplus, which helped to mitigate the drop in GDP. In Bolivia, the growth of the trade surplus comfortably offset the downturn in domestic demand, making a positive contribution to growth of GDP.

In 1994 per capita private consumption in Argentina, Brazil, Colombia, Costa Rica, Ecuador, El Salvador, Paraguay, Peru and Uruguay swelled by between 3% and 9%, while in another three countries (Chile, Mexico and Panama), the increase was slight. In two countries (the Dominican Republic and Nicaragua) per capita private consumption was relatively stable. In Bolivia, Haiti, Honduras and Venezuela, on the other hand, the slide was a steep one (between 5% and 14%). Thus, per capita private consumption declined in less than one fourth of the countries of the region, which is an improvement over the situât ion in the 1980s, when reductions in this indicate r of well-being were widespread.

In general, levels of per capita private consumption continued to bo significantly lower than at the start of the previous decade, since the upswing seen between 1991 and 1994 constituted no more than a vîry incomplete recovery from the downturn,in this variable that occurred between 1981 ami 1990. Indeed, per capita private consumption was higher in 1994 than it had been at the stjirt of the 1980s in only five of the 19 countries for which information was available. In four of those five (Chile, Colombia, Paraguay ami Uruguay), the cumulative rise ranged from 11% to 31%, while in El Salvador it was 6%. The largest cumulative decreases in per capita private consumption were in Haiti (-50%), Nicaragua (-45%), Bolivia, Peru and Vem zuela (between -14% and -25%). In Costa Rica, the Dominican Republic, Ecuador, Guatemala and Honduras, the decreases ranged between 6% and 9%, while in Argentina, Brazil, Mexico and Panama, this indicator of veil-being still stands at between 2% and 4% below its 1980 levels (see figure III-l).

3. **Liberalization and changes in the supply and demand structure**

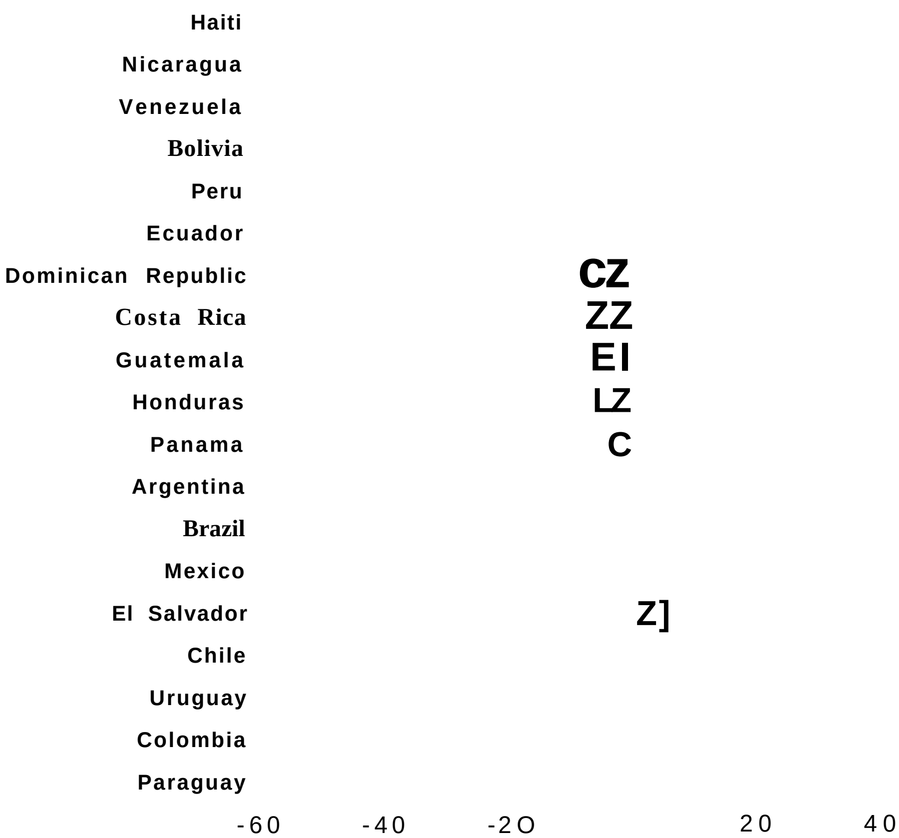
The region's supply and demand structure underwent significant changes during the first half of the 1990s, sparked by adjustment processes, a real appreciation in local currencies and economic reactivation. The export share of total demand increased by just over 1%, while the contribution made by gross capital formation to domestic demand rose slightly and the contribution made by consumption decreased. The variations in total supply were more sizeable, due to the headlong growth of imports, whose share of total supply increased by 4% during the same period.

In the current decade, the coefficient for exports of goods and services climbed significantly, by 3.5 points of GDP, thereby continuing the rising trend seer in the previous decade and strengthening still further the process of developing the region's exporting capacity, a process which had begun in the nidst of the debt crisis at the start of the 1980s. TI le increase in the coefficient for exports was "widespread, inasmuch as between 1990-1994 it spread to 14 of the 19 countries for which information was available. Bolivia, Costa Rica, Ecuador and Paraguay marked up the largest increases (between 7 and 11 points of GEP), while Brazil, Chile and El Salvador boosted heir coefficients by around 4 points. In Colombia, the Dominican Republic, Mexico, Paraguay,] Nicaragua, Peru,

Figure III-l

LATIN AMERICA AND THE CARIBBEAN: PER CAPITA PRIVATE CONSUMPTION

(Cumulative percentage variation 1981-1994)



Source: ECLAC, on the basis of official figures.

Uruguay and Venezuela the rise ranged from 1 to 3 points of GDP. In Guatemala, however, the indicator edged downward; in Argentina and Honduras it fell by around 3 points of GDP, and in Haiti it dropped by 9 points.

The coefficient for imports of goods and services as a percentage of GDP rose notably between 1990-1994, following the decline of the 1980s; it reached 6 points of GDP, which helped it to exceed its 1980 levels. The 1994 import coefficients were higher than their 1990 levels in 16 of the 19 countries of the region for which information was available. The sharpest increases were in Colombia, Costa Rica, El Salvador, Paraguay and Uruguay, where they ranged between 10 and 20 points of GDP. Significant increases of over i i points also occurred in Argentina, Brazil, Guatemala, Mexico and Peru.

In nearly all the countries mentioned, import coefficients had declined at the start of the previous decade, the period in whi< h the external debt crisis erupted. This was followed by a gradual upswing, a trend which intensified in the current decade, owing to the trade liberalization policy, the overvaluation of exchange rates and abundant inflows of foreign capital.

Variations in exports and imports were reflected in substantial changes in the Latin American and Caribbean countries' trade balances. The region as a whole hid marked up a significant surplus by the end of 1 he 1980s and

Table III-5
LATIN AMERICA AND THE CARIBBEAN: RELATIVE SHARES OF COMPONENTS OF GROSS DOMESTIC PRODUCT AND GROSS NATIONAL INCOME, AT MARKET PRICES [a]
(GDP = 100)

	Total final consumption expenditure	Gross fixed capital formation	Domestic demand	Exports of goods and services	Imports of goods and services	Terms-of-trade effect	Net factor pay ments tc rest of world	Real gross national income
1980	78.2	23.5	101.7	14.1	15.8	–	2.6	97.6
1981	77.9	23.3	101.2	15.0	16.2	-0.8	3.7	95.7
1982	77.2	20.7	97.9	15.5	13.3	-2.4	5.1	92.7
1983	76.2	17.2	93.4	17.1	10.5	-2.7	4.9	92.6
1984	76.3	16.6	92.9	17.9	10.8	-2.3	5.2	92.8
1985	76.3	16.6	93.0	17.6	10.6	-3.0	4.9	92.5
1986	76.9	17.2	94.1	16.8	11.0	-4.1	4.5	91.8
1987	76.4	17.2	93.6	17.5	11.2	-4.2	3.9	92.3
1988	76.2	17.0	93.2	18.9	12.1	-4.4	4.1	91.9
1989	76.1	16.3	92.4	19.8	12.2	-4.7	4.3	91.5
1990	76.6	15.9	92.5	20.7	13.2	-5.0	3.7	92.0
1991	77.4	16.4	93.8	20.9	14.7	-5.5	3.4	91.9
1992	78.0	17.5	95.5	21.6	17.1	-5.6	3.1	92.2
1993	77.6	18.1	95.7	22.4	18.1	-6.0	3.2	91.5
1994 [c]	77.2	19.0	96.1	23.2	19.3	-5.7	3.1	92.1

Source: ECLAC, on the basis of official figures converted into dollars at constant 1980 prices.
* Nineteen countries. [B] Includes variation in stocks. [c] Preliminary figures.

the start of the 1990s; however, this surplus then declined steeply, so that by 1994 it had dropped by nearly 4 points of GDP, as compared with the 1990 trade balance.[3] Be that as it may, the dwindling of the trade surplus allowed for an equivalent growth of domestic demand, which was channelled ma nly towards increased investment. The coefficient for investment as a percentage of GDP rose by 3 points, while the total consumption ratio rose by only slightly more than one half point (see table III-5).

4. Investment and its financing

The upturn in investment that had begun in 1991 strengthened in 1994, as shown by the increase in the regional coefficient of gross capital formation to 18% of GDP. The 1994 investment coefficient, for its part, was higher than the 1993 ratio in most countries of the region, with particularly notable increases being registered in Peru (from 19% to 22.9%), Argentina (from 19.9% to 21.9%), Brazil (from 14.1% to 15.8%), El Salvador (from 19.7% to 21.2%), Honduras (from 23.5% to 24.9%) and Mexi co (from 20.7% to 21.7%). Increases also occurred in Colombia, the Dominican Republic, Panama and Paraguay, amounting to less than 1% of GDP , In another four

[3] In accordance with the national accounts statistics prepared by ECLAC, the trade surplus, in constant 191 ¡0 prices, was 7.5% of GDP in 1990 and 3.9% in 1994. However, preliminary estimates indicate that if a new base year was used, for example, 1990, the 1990 surplus would have been only 2.6% of GDP, while for 1994 it would show a deficit of 1%. The difl erence made by the change in the base year is attributable mainly to the high prices which regional export products fetched in l'>80, but which then declined considerably. In the statistics using 1980 as the base year, this was reflected in very large coefficients for exports as a percentage of GDP, as well as in a terms-of-trade effect with a minus sign for all the years in the series.

countries (Chile, Costa Rica, Ecuador and Uruguay) the coefficient was relatively constant. In Bolivia, Guatemala and Nicaragua it edged downward, while in Venezuela it fell by nearly 5 points. Haiti had the lowest coefficient for gross capital formation, which declined again in 1994, this time by 5 points of GDP (see table III-6).

Despite the increases in gross capital formation in recent years, the regional coefficient of gross fixed investment for the period 1992-1994 was only slightly more than 18%, which is considerably less than the 23% figure registered for the period 1979-1981. This decline was widespread, although its characteristics were not the same in all the countries of the region. During the most recent three-year period, most of the countries recorded significantly lower average coefficients than they had prior to the crisis of the early 1980s. Thus, between the above two periods the investment coefficient slipped by between 8 and 11 points of GDP in Brazil, Ecuador, Haiti, Uruguay and Venezuela and by between 2 and 6 points in Argentina, Bolivia, Guatemala, Mexico, Paraguay and Peru. In Colombia, the Dominican Republic and Nicaragua, the level was similar in both periods. The only countries that managed to improve their investment coefficients were Chile, Costa Rica, El Salvador, Honduras and Paraguay (see figure III-2).

The recent increases in gross capital formation were reflected in a significant expansion in imports of capital goods, whose regional value increased by 23% with higher rates in Argentina and Peru (50%), Brazil (46%), Ecuador (45%), Paraguay (39%) and Colombia (32%), and moderate ones in El Salvador, Mexico and Panama (between 13% and 20%). In contrast, Haiti's and Venezuela's imports of capital goods fell by between 28% and 33% as a result of sluggish investment and the recession affecting these countries. In Bolivia, whre the country maintained its moderate pace sf expansion, imports of capital goods declined by 13% as a result of the downturn in investnw nt.

In 1994 investment financing was much the same as it had been in the precedin g year. During the most recent four-year period, d< >mestic saving remained constant at around 2!.5% of GDP, which was slightly lower than the 1990 level (23.2%). National saving increased slightly, to hold steady at nearly 15% of regional GDP, which was due to the fact that the terms of trade improved in 1994 while net factor payments abroad diminished somewhat. Nevertheless, outbound flows of profits and interest still took up nearly 14% of gross domestic savings. External saving, which had been up during the preceding three years, remained constant at around 4% of GDP, in contrast to ils scanty 1990 level of 0.5%. Influencing this trend was the headlong growth of capital flows since 1991, which meant that in the most recent two-year period, the contribution of extc rnal savings (which include net capital income from the build-up of international reserves) reached its highest levels since 1983. Thus, exiernal savings contributed nearly one fourth of investment financing (see table III-7).

5. **Inflation**

In 1994 inflation rates continued to decline in the vast majority of countries in the region; of the 22 countries considered, only five showed a clearly unfavourable pattern. In the remaining 17 countries, inflation either fell or continued to climb very slowly. Costa Rica, the Dominican Republic, Haiti, Honduras and Venezuela registere d significant rises in inflation rates, which,however,did not reach the extreme levels of tie 1980s and the early years of the current decade (see tableI-4).

[4] It may be supposed that the volume of capital goods imports tended to grow at much the same pace as their value, since the unit prices of imports of manufactures increased only slightly in 1994.

The explanation of this wide gap between domestic and national saving lies in the base year used for calcul ating the series. For example, if 1990 were selected as the base year, the gap would be substantially smaller, since the terms of trad : would register only a small decline in 1994 as compared with 1990.

Table III-6
LATIN AMERICA AND THE CARIBBEAN: INVESTMENT RATIOS
(Gross fixed investment as a percentage ofGDP)

	1980	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994[a]
Latin America and the Caribbean	**23.5**	16.6^	**17.2**	**17.2**	**17** J)	**16.3**	**15.9**	**16.4**	**17.5**	**18.1**	***19,0***
South America	**23.4**	**16.2**	**17.5**	**17.5**	**17.2**	**16.0**	**14.8**	**15.2**	**16.1**	**17.0**	**17.9**
Argentina	25.0	15.9	16.4	18.1	17.9	14.9	13.4	15.4	18.6	19.9	22.1
Bolivia	14.2	12.4	13.4	13.7	13.6	12.6	12.4	12.5	14.1	14.3	12.9
Brazil	22.9	16.0	18.2	17.4	16.5	16.2	15.1	14.6	13.3	14.1	15.8
Chile	16.6	14.2	13.8	15.8	16.8	19.0	18.7	17.2	19.6	21.7	21.6
Colombia	16.8	15.7	15.8	15.1	16.1	14.7	13.7	12.6	13.7	17.3	18.6
Ecuador	23.6	15.0	15.3	16.7	14.6	14.5	13.5	14.2	14.7	14.6	14.7
Paraguay	27.2	19.4	20.0	20.4	19.8	20.7	22.1	22.9	21.0	20.7	21.0
Peru	23.5	15.7	17.1	18.8	17.7	16.0	17.3	17.3	18.3	19.0	22.9
Uruguay	21.0	8.3	8.6	10.1	10.6	10.4	9.2	11.0	12.1	13.0	12.9
Venezuela	29.0	20.3	20.7	20.1	20.6	16.7	14.7	18.1	21.8	20.5	15.8
Mexico	**24.8**	**17.9**	**16.4**	**16.1**	**16.8**	**17.3**	**18.7**	**19.6**	**21.1**	**20.7**	**21.7**
Central America and the Caribbean	**19.8**	**16.1**	**16.8**	**17.6**	**16.6**	**17.6**	**16.5**	**16.3**	**19.0**	**21.0**	**21.1**
Costa Rica	23.9	18.5	19.6	20.7	19.3	21.2	23.4	20.0	22.7	26.3	26.2
El Salvador	13.6	12.5	13.5	14.3	14.7	16.0	14.7	16.6	18.3	19.7	21.2
Guatemala	15.7	9.8	10.2	11.5	12.4	12.7	11.1	11.1	13.8	14.1	13.5
Haiti	17.2	20.9	19.1	19.5	18.5	17.3	16.1	17.7	11.2	10.8	5.3
Honduras	24.5	17.5	14.0	14.2	16.4	18.9	18.1	17.7	21.2	23.5	24.9
Nicaragua	14.6	19.8	18.7	19.1	19.2	19.5	16.0	14.4	13.2	15.2	14.7
Panama	24.1	19.2	20.4	20.0	10.8	8.8	11.0	18.2	23.6	29.5	30.0
Dominican Republic	23.9	18.7	21.4	22.4	21.7	23.6	21.0	18.6	21.7	22.8	23.2

Source: ECLAC, on the basis of official figures converted into dollars at constant 1980 prices.
[a] Preliminary figures.

During the early months of 1995, that trend has generally continued, except in the case of Mexico. In some countries inflation rates continued to fall and in others only slight increases were noted. In Mexico inflation surged heavily in 1995, which brought the 12-month rate to 38% in June, after it had been only 7% in 1994.

Brazil's anti-inflation efforts had notable results, since thanks to its stabilization plan, which had begun in 1993, the pace of price increases, then 2,500%, fell to 930% in 1994 and to only 34% during the 12 months ending in June 1995. (In the first half of 1994 the 12-month inflation rate had reached 5,000%). This put an end to the last of the virtually hyperinflationary situations that had prevailed in the region during the preceding 15 years. Bolivia's inflation rates have been moderate since 1986 and were less than 10% in 1993 and 1994. Since 1992, Argentina has also managed to control its inflation rate, which was under 4% in 1994 and has remained low in 1995. In Peru the pace of price increases dropped from 40% in 1993 to 15% in 1994; this falling trend continued into the first half of 1995 and helped to strengthen control of inflation, after the excessively high rates registered between 1988 and 1990. In Nicaragua, the annual price increase has ranged between 4% and 20% since 1992, in clear contrast to the previous years' levels, which reached a high point of 34,000% in 1988 (see table 1-4).

Other countries whose inflation rates, while high, are still substantially lower than those mentioned earlier also managec to lower them;

Figure m-2
LATIN AMERICA AND THE CARIBBEAN: GROSS FIXED CAPITAL INVESTMENT
AS A PERCENTAGE OF GROSS DOMESTIC PRODUCT [a]

Source: EC LAC, on the basis of official figures.
[a] Countries are listed in the order of their investment ratios for the period 1979-1981

thus, Ecuador's index fell to 25% in 1994, while Uruguay's decreased, but remained above 40%. In contrast, Jamaica's inflation, which has been somewhat high since 1990, increased slightly in 1994, which brought the rate to 33%. In the case of Colombia, the situation remained stable, with annual increases of nearly 23%; the same was true for Paraguay, where the increases have been somewhat less than 20%. In Guatemala inflation has hovered at slightly over 10% in recent years.

Chile, El Salvador and Trinidad and Tobago, whose inflation rates had been relai ively low for

Table m-7

LATIN AMERICA AND THE CARIBBEAN: FINANCING OF GROSS CAPITAL FORMATION [a]

	1980	1985	1986	1987	1988	1989	1990	1991	19<>2	1993	1994[b]
	Percentages of gross domestic product										
1. Gross domestic saving	23.0	24.3	22.7	23.7	24.2	23.7	23.2	22.7	22,4	22.5	22.7
2. Net factor payments abroad	**2.6**	**4.9**	**4.5**	**3.9**	**4.1**	**4.3**	**3.7**	**3.4**	**3,1**	**3.2**	**3.1**
3. Unrequited private transfer payments abroad	**0.2**	**0.3**	**0.4**	**0.4**	**0.4**	**0.5**	**0.6**	**0.8**	**0 9**	**0.7**	**0.9**
4. Terms-of-trade effect	**0.0**	**-3.0**	**-4.1**	**-4.2**	**-4.4**	**-4.7**	**-5.0**	**-5.5**	**-5,6**	**-6.0**	**-5.7**
5. Gross national saving (1+2 + 3 + 4)	20.5	16.8	14.5	16.0	16.1	**15.1**	15.2	14.6	14,6	14.0	14.8
6. External saving	**4.1**	**0.5**	**2.4**	**1.3**	**1.3**	1.0	**0.5**	**1.8**	**3,3**	**4.1**	**4.0**
7. Gross capital formation (5 + 6)	24.7	17.3	16.8	17.3	17.4	16.1	15.7	16.4	17,9	18.1	18.8
	Other percentages										
Domestic saving/gross capital formation	93.1	140.7	134.9	136.8	139.0	147.0	148.1	138.0	125,4	123.9	120.6
Terms-of-trade effect/ domestic saving	0.0	-12.2	-18.1	-17.6	-18.2	-19.9	-21.4	-24.2	-24,8	-26.5	-25.0
Net factor payments abroad/domestic saving	-11.2	-20.1	-19.8	-16.6	-17.1	-18.1	-15.8	-14.8	-13,9	-14.4	-13.5

Source: ECLAC, on the basis of official figures converted into dollars at constant 1980 prices.
[a] Nineteen countries. Preliminary figures.

several years, were able to consolidate this trend in 1994 by reducing annual price increases to single-digit rates. Lastly, in Barbados and Panama, countries in which inflation has always been low, that situation continued into 1994, with Barbados even having a negative rate and Panama an increase of barely 1%.

Of the five countries in which inflation rates flared significantly, the Dominican Republic went from only 3% in 1993 to 12% in 1994 and Costa Rica from 9% to 20%, while Honduras's inflation rate rose somewhat more, from 13% to 29%. In contrast, Haiti's annual inflation rate continued to spiral upward until it exceeded 50%, fuelled by the serious political crisis, which, in turn, was sparked by an economic blockade in place during nearly the whole of : L994 and a fiscal deficit financed solely through increased money issues. Venezuela registered the largest jump in inflation, from 46% to 71%, as a result of the serious fiscal and exchange-rate crisis affecting the country. In the early months of 1995, its annual rate remained constant at around 70%. Brazil's rate during the sam< period amply exceeded that level, becoming the highest in the region. However, these inflation rates, despite the increases, are well below those which prevailed in Latin America in the recent past.

The decline in regional inflation rates was partly due to the fact that in 1994 the Brazilian economy, the region's largest, joined in the stabilization programmes already under way. Brazil instituted an innovative plan aimed at drastically reducing inflation, which was very high due to its inertial aspects, these, in turn, being the result of a highly indexed economy. The plan had notable effects, since the monthly rate of price increases, which had been nearly 50% in June 1994, fell to around 2% on average over the following 12 months.

The favourable results obtained in other countries are attributable to the carrying forward of the macroeconomic policies adopted in previous years, whose main objective continued to be to quell inflation. The strategies implemented carried forward the establishment of fiscal austerity and prudent monetary policies, as well as the extension of trade liberalization, especially through regional agreements to eliminate tariffs between trading partners. Exchange rates, meanwhile, played an important role in the evolution of consumer prices in most countries of the region, either by supporting anti-inflationary efforts in situations characterized by an abundant supply of foreign exchange, or by contributing to price increases in situations where external weakness made it necessary to expedite the pace of devaluation.

In nearly all countries in the region, fiscal policy has succeeded in balancing public accounts. Progress in fiscal reform, the application by public enterprises of more realistic pricing policies, the persistent effort to control tax evasion and the resources stemming from privatization have continued to increase real income. Meanwhile, the volume of expenditure has remained smaller, especially as regards investment; while this has promoted fiscal equilibrium, it also entails some degree of uncertainty as to the long-term viability of such policies.

During 1994 a group of counties succeeded in keeping fiscal balances within acceptable limits so that no pressure on domestic lending was generated. The expansion of tlie fiscal deficit and its financing through growth in the money supply played a decisive role in increasing inflation only in Costa Rica, tlie Dominican Republic, Haiti and Venezuela. Tie failure of a State bank in the first case, and widespread bank failures in the second, gave rise to massive parafiscal deficits which had a sigrificant impact on the money supply, especially in Venezuela, while in Haiti the serious situation in the public sector meant that the bulk of the fiscal deficit had to be financed through money creiition.

Thus, except in a few cases, monetary policy has been facilitated by fiscal management, as well as by an upturn in the demanc for money in an environment of declining expectations of inflation. This means that the challenges posed by ensuring that growth in the noney supply remains consistent with the goals of economic growth and low inflation have renamed linked to external capital flows. Thus, donestic interest rates have had to grapple with the conflict between increasing compïtitiveness, anti-inflationary targets and the financing of the external current-account deficit. However, in most countries, as in previous year», priority has been given to the goal of stabilizing prices, as a result of which real interest rates have remained very high and, in some cases have even increased. In several countries local currencies appreciated again, while tlie cost of implementing policies to sterilize tlie excess cash was high.

6. **Employment**

Following the gradual improvement in the urban open unemployment rate of the Latin American and Caribbean economies during the second half of the 1980s, this trend slowed in the early 1990s, and unemployment even increased again slightly. In addition, the upturn in economic activity in 1994 was not reflected in lower unemployment levels. In fact, witl the increase in the urban open unemployment rate for the region as a whole from 6.2% in 19! »3 to 6.4% in 1994, this indicator returned to levels not registered since 1985 (see table III-8).

Several of the largest countries in the region contributed to this adverse result. Thus, in

Argentina, the average annual rate of urban open unemployment rose from 9.6% in 1993 to 11.5% in 1994, with the situation worsening in the second half of the year, added to which was an increase in the underemployment rate. In Chile the level of unemployment grew from 4.1% to 6.3% in the Metropolitan Region and from 4.7% to 6% nationwide. In Colombia the average annual rate climbed from 8.6% in 1993 to 8.9% in 1994; however, towards the end of the year, an improvement in the situation meant that by December the rate was the same as it had been in December of the preceding year. In Mexico urban unemployment increased slightly from 3.4% to 3.7%. In Venezuela the nationwide open unemployment rate increased from 6.6% to 8.7%. Increases in the unemployment rate were registered also in Bolivia, Costa Rica, Honduras, Panama and Uruguay. In Cuba, while the levels could not be quantified, the critical economic situation was expressed in very high underemployment rates.

In other countries, however, the unemployment rate fell. In Brazil, after fluctuating throughout 1994, urban unemployment dropped drastically at the end of the year, owing to the economic expansion generated by the Real Plan. Because of this plan, the unemployment index for 1994 as a whole was favourable. Underemployment followed a similar path, with rates higher than the 1993 levels in the first half of the year and declining ones in the second half. Ecuador, El Salvador, Guatemala, Nicaragua, Paraguay and Peru also registered drops in the open unemployment rate, attributable mainly to their high economic growth rates. However, in all these countries, underemployment levels continued to be significant.

In contrast to the expansion of unemployment in the region as a whole during the early years of the 1980s -which was also much more marked- the increase in unemployment in the current decade is not based on a widespread slowdown in economic activity, but on other factors. Only in the cases of Honduras and Venezuela was a drop in GDP the main cause of the worsening of unemployment.

Some of the other factors which contributed to raising the level of unemployment included stabilization and adjustment policies. Thus, in Argentina, sharp cutbacks in the public sector, partly in the context of privatization policies, entailed the dismissal of a large number of public-sector workers, many of whom have had serious difficulties in findiig alternative employment. In Chile, the stabilization policy has limited domestic demand and job creation in the non-tradable goods sectors, especially construction.

In other countries the increase in unemployment had its or gin in trade liberalization, which has affectée employment in industries facing increased foreign competition. Thus, in such countries as Argent ina, Mexico and Uruguay, massive job losses wire registered in certain industrial branches whici have not been offset by job creation in expanding activities. In other countries, such as Brazil, his process has not yet developed to the sane extent, and liberalization has affected only certain low labour-intensive industries.

In the same context, and also in order to cope with the consequences of trado liberalization, changes in the factor mix wer; introduced in many industrial sectors which ¡generated sharp increases in labour productivity That was seen especially in Argentina, Brazil, Colombia, Mexico, Peru and Uruguay, where smaller numbers of workers were ne;ded. Thus, in Argentina, while industrial outout climbed by nearly 4%, the index of new hring in Buenos Aires fell by nearly 50% as conpared with the previous year.

In other countries, meanwhile, the rise in unemployment was due to increased participation in the labour market, as a result of which the growth in the labour supply exceeded the rate of job creation, which, ir turn, was fairly low. Increased participation can reflect long-term structural trends, sucl as the growing integration of women into the labour market. Thus, in Costa Rica, Uruguay and Venezuela, women represented a larger share of the labour market in 1994 than did men. Tie opposite was true in Argentina and Colombia, where the rate of participation fell, cushioning the rise in unemployment levels.

Another factor which migtt have had an impact on the tendency fcr the rate of

Table **III-8**

LATIN AMERICA AND THE CARIBBEAN: URBAN OPEN UNEMPLOYMENT

(Average annual rates)

	1987	1988	1989	1990	1991	1992	1993	1994[a]
Latin America	5.7	5.8	5.4	5.8	5.8	6.2	6.2	6.4
Argentina	5.9	6.3	7.6	7.5	6.5	7.0	9.6	11.5
Bolivia [c]	7.2	11.6	10.2	9.5	7.3	5.8	5.4	5.8
Brazil[d]	3.7	3.8	3.4	4.3	4.8	5.8	5.4	5.1
Chile [e]	11.9	10.2	7.2	6.5	7.3	5.0	4.1	6.3
Colombia	11.8	11.3	10.0	10.5	10.2	10.2	8.6	8.9
Costa Rica [g]	5.9	6.3	3.7	5.4	6.0	4.3	4.0	4.3
Ecuador	7.2	7.4	7.9	6.1	8.5	8.9	8.9	7.8
El Salvador '		9.4	8.4	10.0	7.5	7.9	8.1	7.2
Guatemala[3]	11.4	8.8	6.1	6.5	6.4	5.7	5.5	5.2
Honduras	11.4	8.7	7.2	6.9	7.1	5.1	5.9	6.3
Mexico	3.9	3.5	2.9	2.7	2.7	2.8	3.4	3.7
Nicaragua[J]	5.8	6.0	8.4	11.1	14.2	17.8	21.8	20.7
Panama [m]	14.1	21.1	20.4	20.0	19.3	17.5	15.5	15.8
Paraguay "	5.5	4.7	6.1	6.6	5.1	5.3	5.1	4.6
Peru[0]	4.8	7.1	7.9	8.3	5.9	9.4	9.9	8.8
Uruguay [p]	9.3	9.1	8.6	9.3	8.9	9.0	8.4	9.1
Venezuela [q]	9.9	7.9	9.7	11.0	10.1	8.1	6.8	8.7

Source: ECLAC, on the basis of official figures.

[0] Preliminary figures. Nationwide urban rate, May-October average. [c] Up to 1988, official estimates; fi om 1989 onward, capital cities of departments and the city of El Alto. Metropolitan areas of Rio de Janeiro, São Paulo, Bel< i Horizonte, Porto Alegre, Salvador and Recife: 12-month average. [e] Santiago Metropolitan Region, 12-month aveage. Seven metropolitan areas, average for March, June, September and December. [8] Nationwide urban rate, up to July. In 1987, Quito, Guayaquil and Cuenca; from 1988 onward, nationwide urban rate. Includes hidden unemployment.

[1] Nationwide urban rate. [J] Nationwide total; official estimates. In 1987, Central District, San Pedro Si la and five cities; from 1988 onward, nationwide urban rate. ' Encompasses a growing number of urban areas, which reacl led 39 in October 1994. [m] Metropolitan area. " Metropolitan Asunción. ° Metropolitan Lima. [p] Montevideo, 12-month average.

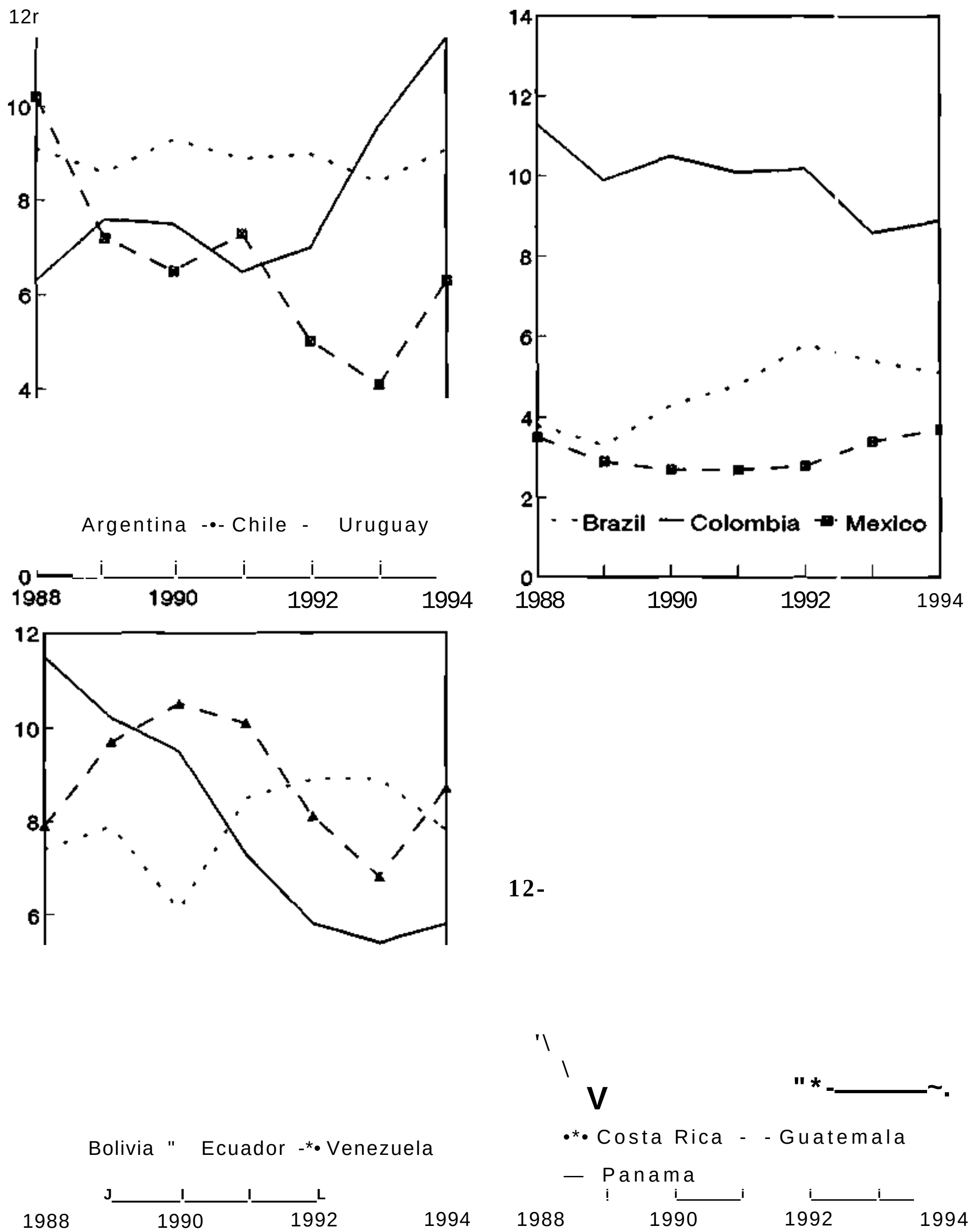
[q] Four-quarter average; in 1994, nationwide total.

participation to grow is wage-earners' response to short-term economic trends. Thus, the economic difficulties affecting many households in Venezuela meant that a larger number of members had to join the work force in the hope of gaining additional sources of family income, which translated into a sharp increase in participation for both women and men.

In 1994, as has been seen for many years, unemployment was concentrated in specific groups within the work force. Thus, it reached high levels among youth, women and people with low levels of education and job training. Recently, however, in some countries it has also affected groups that have traditionally enjoyed relatively stable employment. In Argentina, unemployment in the higher age bracket registered a sharp increase, owing to the restructuring of the public sector. This problem was worsened by the fact that the characteristics of the training received by many of those affected make it difficult for them to find new jobs. In addition, the critical situation in some industrial activities and restructuring processes in others have generated levels of industrial unemployment above the urban average in such countries as Argentina, Brazil, Costa Rica, Ecuador and Uruguay.

There also continued to be major differences in unemployment levels between the various urban centres within a single cour try (see table III-9). Thus, in Argentina, while lhe decline in employment was widespread in all metropolitan areas, the discrepancies between more severely affected cities and those with higher levels of economic activity increased. It is also worth mentioning that in Greater Buenos Aires, where unemployment rates have generally been below

Figure III-3
LATIN AMERICA AND THE CARIBBEAN (SELECTED COUNTRIES) : URBAN UNEMPLOYMENT
(Average annual rates)



Source: ECLAC, on the basis of official figures.

the urban average, this situation has changed since 1993. The main reason for this is the mixed performance of the participation rate, which in Greater Buenos Aires grew steadily in recent years, until 1993, while in all other urban areas it remained practically constant. In contrast to Argentina's experience, Colombia witnessed a process of homogenization of unemployment rates, since they increased in the metropolitan areas that had lower levels of unemployment and fell in Medellin, where this indicator had previously been higher.

In Brazil's greater metropolitan areas, the improvement in employment registered in 1994 primarily benefited São Paulo and Recife, while in other urban centres the unemployment level remained unchanged, and in Salvador de Bahía it actually increased. The north-eastern cities continued to display high rates of unemployment as compared with the national average. Be that as it may, the index improved at the end of the year in all metropolitan areas. In Mexico, unemployment trends in the major metropolitan areas were uniform, so that the previous inconsistencies remained, while in Ecuador, a sharp drop in unemployment in Quito contrasted with a slight increase in Guayaquil.

In some cases, internal migration promoted processes of homogenization of unemployment levels, while in others vast discrepancies persisted or even increased. It must be assumed that, among other factors, qualitative differences in the supply of and demand for labour impeded the development of uniform conditions in the region's labour markets.

Lastly, it should be recalled that the open unemployment figures reveal only part of the total picture of employment problems. A fuller analysis would have to take into account the situation of discouraged job-seekers who have stopped actively looking for work, as well as the underemployment of many other persons registered as employed. However, not all countries in the region have generated the relevant data.

The structure of employment has also changed significantly in recent years. In many countries, industrial restructuring resulting from the elimination of certain activities, as well as the diminished use of labour made possible by modern technology, has led to a iecrease in the relative strength of the manufacturing sector within the occupational structure, or even to an absolute decline in industrial employment. Thus, in Argentina, Chile, Colombia, Ecuador, Mexico, Panama, Peru and Unguay, modern industrial employment decreased in absolute terms, despite the substantial growth of sectoral output in some cases (see table III 10). In Brazil, employment in formal industry remained stable nationwide, but shrank in metropolitan areas.

Moreover, in the Dominican Republic, Mexico and some Central American countries, the inbond assembly (maquilac ora) industry constituted an important employment-generating industrial activity, although the Central American countries have witnessed the first displacement effects of the North *t* American Free Trade Agreement (NAFTA). The automotive sector was also a significant source of job creation in such countries as Argentina, Brazil and Mexico.

Meanwhile, the increase in construction activity once again significantly spurred the demand for labour in Costa Rica, Ecuador and Mexico. On the other hand, in si ch countries as Chile, Guatemala, Uruguay and Venezuela, the slower growth of construction contributed to worsening the situation in the labour market.

In general, the countries for which information is available continued to witness a long-term declining trend in the strength of agriculture within the occupational structure. In some countries, such as Chile anc Costa Rica, agricultural employment actually decreased in absolute terms. In Guatemala and Mexico formal employment in agriculture aluo receded. Venezuela constituted an important exception in this regard, since employment in this sector grew in 1994 despite shrinking agricultiral output, a phenomenon which reflects th; nature of subsistence agriculture as a last resort in times of crisis.

In contrast to what occurred in primary and secondary activities, employment in the tertiary sector expanded again, which indicates that the trend towards tertiarization of the labour market is continuing. Specifically, employment in some services (communication, transport, finance and

Table **III-9**

LATIN AMERICA AND THE CARIBBEAN: OPEN UNEMPLOYMENT RATES IN MAJOR CITIES [a]

	1990	1991	1992	1993	1994[b]	1993				1994[b]			
						I	II	III	IV	I	II	III	IV
Argentina													
Greater Buenos Aires	7.3	5.8	6.7	10.1	12.1		10.6		9.6		11.1		13.1
Córdoba	5.8	4.8	5.1	6.8	8.7		6.8		6.0		7.8		9.6
Greater Mendoza	5.9	4.3	4.3	4.5	5.6		4.4		4.6		6.0		5.1
Greater Rosario	8.5	10.2	9.3	11.3	12.8		10.8		11.8		13.1		12.4
Greater Tucumán	10.5	11.6	12.3	13.0	14.5		14.2		11.8		14.8		14.2
Brazil [c]													
Rio de Janeiro	3.5	3.6	4.0	4.1	4.1	4.3	4.1	4.3	3.9	4.5	4.2	4.2	3.3
São Paulo	4.5	5.5	6.5	5.7	5.4	6.5	6.4	5.2	5.1	6.1	5.5	5.8	4.2
Belo Horizonte	4.1	4.1	4.8	4.6	4.3	5.3	4.7	4.4	3.8	5.0	4.2	4.4	3.1
Porto Alegre	3.7	4.3	4.8	4.2	4.1	4.5	4.8	4.0	3.2	4.3	43	4.4	3.4
Salvador	5.4	5.6	6.7	6.8	7.1	7.5	6.6	7.1	5.9	7.3	7.8	6.9	6.3
Recife	5.7	5.9	8.5	9.0	6.8	9.2	9.9	9.4	7.4	7.7	S.3	6.6	5.0
Chile													
Greater Santiago	9.6	7.4	6.0	6.3	6.8	6.4	6.4	6.4	5.9	7.5	(.3	6.4	6.9
Colombia													
Bogotá	9.4	8.6	8.4	6.4	7.1	7.3	7.0	5.3	5.8	8.2	'.7	5.0	7.3
Barranquilla	10.9	9.7	11.0	9.9	10.7	11.2	9.3	9.1	10.1	11.5	1I..0	10.3	8.8
Cali	9.6	9.4	9.7	9.1	10.0	8.7	10.8	9.2	7.7	10.9	10.5	11.5	7.0
Medellín	12.5	13.8	13.8	11.8	10.5	13.2	12.0	11.4	10.5	13.3	1I..1	8.6	8.1
Ecuador													
Guayaquil	5.9	5.5	6.3	7.0	7.3				7.0		r.i		7.5
Quito	5.6	7.1	6.4	7.0	5.1				7.0		;.5		4.7
Mexico													
Mexico City	3.2	3.0	3.3	3.9	4.1	4.2	3.5	4.1	3.7	4.3	':2	3.8	4.2
Guadalajara	1.6	2.5	3.0	3.0	3.4	3.0	2.7	3.3	3.1	3.6	'i.i	3.8	3.1
Monterrey	3.4	3.6	3.2	4.8	5.1	5.0	4.8	5.4	4.4	4.7	4.9	5.2	5.5
Uruguay													
Montevideo	9.3	8.9	9.0	8.4	9.1	9.0	8.8	8.3	7.3	8.1	i 1.9	10.4	9.1

Source: ECLAC and International Labour Organization (ILO), on the basis of official figures. For Greater San iago: Department of Economics, University of Chile.

[a] The period covered by the rates corresponds to the original for each country. Preliminary figures. [c] In 1992, the annual figures are for 10 months, and the figures for the second and third quarters do not include June and July, n ¡spectively.

community, social and personal services) was stimulated by economic policy reforms. In particular, significant growth was seen in formal employment in such activities in Brazil, Chile, Ecuador and Peru.

In many countries public-sector employment continued to fall in relative and even absolute terms. The available statistics for 1994 showed setbacks in relation to the previous year in Argentina, Costa Rica, Ecuador, Nicaragua, Panama and Venezuela.

Thus, the economic restructuring now under way within the modern sector led to a revival of manufacturing; however, to the extent that it contributed to increased labour productivity, it also led to job losses in many cases, at least in the short term. The public sector, for its part, lost its employment-generating function, while a larger number of jobs are apparently being generated in modern tertiary activities linked to the processes of liberalization and modernization. Another indicator of the effects of modernization on the labour market was the increase seen, primarily in Argentina and Chile, in the proportion of professionals and technicians in the work force.

Table III-10

LATIN AMERICA AND THE CARIBBEAN: INDICATORS OF INDUSTRIAL EMPLOYMENT

	1980	1985	1988	1989	1990	1991	1992	1993	1994 [a]
			Indexes (1990 = 100)						
Formal **industrial** employment									
Brazil									
Metropolitan areas	114.6	90.6	101.0	103.2	100.0	93.2	87.5	86.0	85.0
São Paulo	100.7	92.3	101.6	103.2	100.0	92.7	86.2	84.6	83.4
Rio de Janeiro	99.3	92.7	100.8	103.1	100.0	94.2	87.7	84.5	82.6
Colombia [c]	111.6	91.9	97.7	98.3	100.0	101.2	102.4	103.8	101.3
Ecuador		101.3	99.0	98.1	100.0	101.1	97.6	96.2	89.7
Guatemala [e]	81.5	76.7	100.7	97.8	100.0	114.2	125.7	130.6	138.7
Mexico	93.4	91.2	96.2	98.7	100.0	99.3	97.3	93.2	91.3
Mexico City [g]	105.7	99.7	98.6	99.9	100.0	98.6	95.0	88.9	85.2
Mexico City	26.0	46.2	81.7	91.6	100.0	102.8	110.5	118.7	128.1
Peru [l]	122.9	102.5	113.7	102.7	100.0	94.9	85.1	78.2	77.2
Uruguay [J]	94.5	100.9	106.2	106.1	100.0	94.6	85.8	74.6	61.3
Venezuela [k]	91.8	87.4	106.4	100.7	100.0	103.7	107.2	105.7	95.3
Total **industrial** employment									
Argentina	140.9	119.5	114.5	105.0	100.0	102.8	103.6	99.9	92.3
Chile [m]	74.6	64.6	85.2	98.0	100.0	103.0	108.9	118.0	114.0
Costa Rica	93.7	93.5	97.9	98.4	100.0	103.1	107.7	107.5	111.2
Nicaragua	127.8	112.0	118.6	110.3	100.0	80.2	71.1	68.3	70.9
Panama [n]	79.4	97.4	90.5	98.7	100.0	101.3	115.3	123.3	
Venezuela	69.6	82.4	108.4	105.6	100.0	110.8	116.2	113.7	113.3
			Percentage variation						
Formal **industrial** employment									
Brazil									
Metropolitan areas			-1.7	2.1	-3.1	-6.8	-6.1	-1.7	-1.2
São Paulo			-2.0	1.5	-3.1	-7.3	-7.0	-1.9	-1.4
Rio de Janeiro			-1.7	2.3	-3.0	-5.8	-6.9	-3.6	-2.3
Colombia [c]			3.1	0.6	1.7	1.2	1.2	1.4	-2.4
Ecuador	...		-2.8	-0.9	1.9	1.1	-3.5	-1.4	-6.7
Guatemala [e]			30.8	-2.8	2.3	14.2	10.1	4.0	6.2
Mexico			2.1	2.7	1.3	-0.7	-2.0	-4.2	-2.0
Mexico City [6]			-0.1	1.3	0.1	-1.4	-3.7	-6.4	-4.1
Mexico City			22.1	12.1	9.2	2.8	7.5	7.4	7.8
Peru '			-3.6	-9.7	-2.6	-5.1	-10.3	-8.1	-1.3
Uruguay [J]			-5.7	-0.1	-5.7	-5.4	-9.3	•13.1	-17.9
Venezuela			5.4	-5.3	-0.7	3.7	3.4	-1.4	-9.8
Total industrial employment									
Argentina			1.0	-8.4	-4.7	2.8	0.8	-3.6	-7.6
Chile [m]			10.8	15.1	2.0	3.0	5.7	8.4	-3.4
Costa Rica			6.9	0.5	1.6	3.1	4.5	-0.2	3.4
Nicaragua			4.7	-7.0	-9.3	-19.8	-11.4	-3.9	3.8
Panama [n]	,,t	..	-14.6	9.1	1.3	1.3	13.8	7.0	
Venezuela			8.5	-2.6	-5.3	10.8	4.9	-2.2	-0.4

Source: ECLAC, on the basis of official figures.

[a] Preliminary figures. The indexes of formal indus trial employment generally reflect the situation in large- an 1 medium-scale enterprises, while those referring to total industrial employment include small-scale and micro-enterprii es, as well as own-account work. [c] Persons employed in industry, excluding coffee-threshing; in 1994, January-November average. [1] Persons employed in industrial enterprises with 10 or more workers. [e] Refers to the number of persons payin, 5 into the social security system. Includes mining Total formal industrial employment. [8] Persons employed in manufac uring: does not include the maquiladora industry. [1] Persons employed in the maquiladora industry. ' Industrial employme: it in enterprises with 100 or more workers in metropolitan Lima. [J] The figure that appears in the 1980 column refers to 198:'.. Persons employed in enterprises with five or more workers. Up to 1990, includes persons employed in manufacturing; from 1991 onward, all persons employed in manufacturing in Greater Buenos Aires. [m] Persons employed in manufacturing in the Metropolitan Region. ° The figure that appears in the 1980 column refers to 1982. The figure for 1990 is an estimate.

However, the tendency for most employment to be generated in activities that are not part of the modern sector continued. While there is limited information in this respect, such countries as Brazil, Chile, Uruguay and Venezuela saw an increase in 1994 in the proportion of smaller-scale enterprises and informal activities in the labour market. In other countries, such as Guatemala, Mexico and Peru, the limited buoyancy of job creation in the modern sector, combined with an ongoing expansion of the work force, led to an increase in the proportion of less productive employment.

7. **Compensation**

In contrast to the worsening employment situation in most Latin American and Caribbean countries, there was a widespread improvement in 1994 in formal-sector compensation (see table III-ll). Thus, the recovery process continued for real wages, which had suffered a sharp deterioration during the 1980s. This tendency has been fairly widespread and persistent since the start of the 1990s. In most countries in the region, wages in the formal sector again reached or exceeded their 1980 levels. However, in some countries, especially Argentina, Nicaragua, Peru and Venezuela, a considerable backlog persisted in this regard. Wage increases in the formal sector varied in size according to country, but were concentrated in a range of between 1% and 4%. The largest increase was in Peru, where, after accumulating heavy losses, especially up to 1990, wages and salaries in the formal sector rose by an average of over 15%.

In Brazil, high inflation in the first half of the year led to wide variations in the real wages received by workers with social security protection. With the drop in inflation, their compensation stabilized at a real level somewhat lower than the average for the first six months. Nevertheless, average annual wages for 1994 posted an increase in absolute terms as compared with 1993. In Argentina and Uruguay, too, wages fell between the first half of 1994 and the second half, when they were about at the level reached towards the end of 1993.

It should be recalled that the wage increases were not absolutely uniform. For example, at the end of 1994, all wage-earners in Brazil who were enrolled in the social security system received real wages that were lower, on average, than those which they had received during the same period in the previous year, while at the same time, industrial compensation in the state of São Paulo increased by over 8% in eal terms. Also in Brazil, after several years of deterioration, the incomes of own-account workers improved in 1994 as compared with those cf wage-earners, especially in the formal sector. Ii Chile, the real hourly compensation of administrative and professional staff increased by tetween 6% and 8%, while that of retail workers lose by only 1%.

The improvement of compensation in a context of erosion of employment appears to reflect a gradually widening gap between highly productive and profitable activities and those of lesser buoyancy in both respects. The first group of activities is capable of generar ng rising earned incomes for an ever smaller segrient of the work force, while for the second grou;) the opposite is true, since such activities are pocrly remunerated and absorb an ever increasing proportion of the population. This polarization of the labour market is leading to growing heterogeneity as a result of increased differentiation in the supply of and demand for labour. In this context, in 1994 several countries, in some casts with external financing, expanded programmes for the promotion of micro-enterprises ¡ind continued to carry out measures designed to modernize and enhance the efficiency of job training programmes, with a view to raising the productivity and earned income s of the sectors lagging behind.

At the start of the 1980s real minimum wages suffered a substantial decline in nearly all countries of the region as a result of high inflation rates and stabilization policies. In some countries a process of recovery had alreai ly begun during the past decade, while in others real wages continued to fall, a difference which partially reflects a varying interpretation of the role of the minimum wage as an instrument of economic and social policy. Indeed, in some countries the

Table **HI-**11

LATIN AMERICA AND THE CARIBBEAN: REAL AVERAGE WAGES

	1980	1985	1988	1989	1990	1991	1992	1?93	1994[a]
				Average annual indexes (1990 = 100)					
Argentina	130.0	135.7	118.0	95.5	100.0	101.3	102.7	1C1.0	102.0
Bolivia [c]		64.9	92.4	97.6	100.0	93.4	97.1	1C3.6	112.8
Brazil[d]									
Rio de Janeiro	94.0	96.2	109.8	111.9	100.0	79.3	79.5	85.7	87.1
São Paulo	88.6	93.8	108.0	111.7	100.0	88.3	85.3	94.6	98.0
Chile [e]	95.4	89.3	96.3	98.2	100.0	104.9	109.6	113.5	118.8
Colombia	85.0	97.4	100.0	101.3	100.0	97.4	98.6	103.2	104.1
Costa Rica [g]	115.8	106.8	97.8	98.4	100.0	95.4	99.3	10?.6	113.8
Ecuador		135.2	110.8	99.3	100.0	104.6	112.8	122.1	132.9
Guatemala [g]	122.5	121.6	117.8	122.2	100.0	93.6	107.6	115.2	122.9
Mexico '	128.3	97.4	92.1	96.5	100.0	106.5	114.3	124.5	129.1
Nicaragua[J]	477.6	262.5	37.3	61.9	100.0	103.2	123.0	1H.8	121.4
Panama	96.2	103.4	99.1	106.6	100.0	103.8	106.2	10U	
Paraguay	102.1	90.1	104.8	108.9	100.0	104.7	103.6	101.5	106.1
Peru[m]	309.3	250.2	208.6	114.5	100.0	115.2	111.1	110.2	127.4
Uruguay [n]	108.5	95.5	108.3	107.9	100.0	103.8	106.1	111.2	112.2
Venezuela °		184.5	144.5	105.9	100.0	89.5	98.7	7:5.3	
				Annual percentage variation					
Argentina			-3.3	-19.1	4.7	1.3	1.3	-1.6	1.1
Bolivia[c]			27.2	5.7	2.5	-6.6	4.0	<i.7	8.9
Brazil[d]									
Rio de Janeiro			5.1	1.9	-10.6	-20.7	0.3	"i.8	1.6
São Paulo			7.1	3.4	-10.5	-11.7	-3.4	1C.9	3.6
Chile [e]			6.5	2.0	1.8	4.9	4.5	2.6	4.7
Colombia			-1.5	1.3	-1.3	-2.6	1.2	4.7	0.9
Costa Rica [g]			-4.5	0.6	1.6	-4.6	4.1	1C.2	3.9
Ecuador			-15.5	-10.4	0.7	4.6	7.8	8.2	8.8
Guatemala [g]			11.1	3.7	-18.2	-6.4	14.9	7.1	6.7
Mexico '			0.7	4.8	3.6	6.5	7.3	8.9	3.7
Nicaragua[J]			-65.5	66.0	61.5	3.2	19.2	-3.4	2.2
Panama			-7.9	7.6	-6.2	3.8	2.3	-0.1	
Paraguay			11.4	3.9	-8.2	4.7	-1.0	0.8	1.5
Peru"[1]			-24.7	-45.1	-12.7	15.2	-3.6	-0.8	15.6
Uruguay [n]			1.5	-0.4	-7.3	3.8	2.2	4.8	0.9
Venezuela °			-11.4	-26.7	-5.6	-10.5	10.3	-23.7	

Source: ECLAC, on the basis of official figures.

[4] Preliminary figures. [b] Average total monthly wages in manufacturing. [:] Wages of private-sector wa kers in La Paz. [d] Wages of workers protected by social and labour legislation. [e] Up to april 1993, average compensation of i rage-earners in non-agricultural sectors. From May 1993 onward, general index of hourly compensation. [f] Wages of marual workers in manufacturing. [8] Average compensation reported by persons enrolled in the social security systen. Average compensation of persons employed in enterprises with 10 workers or more, in mines, manufacturing, wholesale and retail trade and services; in 1985, September-December average. ' Average wages in manufacturing. [J] Average wjiges, excluding compensation in kind and other benefits. [k] Industrial wages in Panama City; from 1990 onward, estinated figures. [1] Average wages in Asunción. ""Wages of private-sector manual workers in Metropolitan Lima. ° Average wages. [0] Average income per urban worker.

establishment of- a minimum wage was seen, in particular, as part of an anti-inflation strategy, while in others emphasis was given to its function as a tool of an incomes policy to benefit lower-income wage-earners.

At the start of the 1990s, too, and specifically in 1994, there were vast differences among the countries of the region from the standpoint of the behaviour of real minimum wages (see table III-12). Thus, three groups of countries could be distinguished in 1994. In the first group a significant increase was registered in average annual real minimum wages as compared with the previous year. This group includes Argentina (although in that country the sharpest increase in the minimum wage had already occurred in the second half of 1993), Ecuador, Peru and Venezuela. However, in all these countries real minimum wages had previously nosedived and are still well below their 1980 levels.

In the second group of countries, the aim of minimum wage policies was to keep pace with price increases, sometimes also taking into account increases in productivity. Thus, real minimum wages rose slightly in Chile, Costa Rica, El Salvador, Mexico and Paraguay, and fell slightly in Colombia. In all the countries in this group, with the exception of HI Salvador and Mexico, the minimum wage has exceeded its 1980 level. In Mexico the minimum wage was revised within the framewort of a broader tripartite agreement, the Pact for Stability, Competitiveness and Employrrent, which was carried forward in September 1994 as the Pact for Well-being, Stability and Ecanomic Growth. In Colombia a similar instrument, the Social Pact, was applied, which in addil ion to raising the minimum wage includes conimitments with regard to increased productivity, job training and price controls.

In a third group of countries, real minimum wages fell significantly, either because their nominal values did not increase (as in Honduras) or because they failed to keep pace with inflation (as in Brazil and Uruguay). In all these countries minimum wage levels were lower than they had been in 1980.

Table III-12

LATIN AMERICA AND THE CARIBBEAN: REAL URBAN MINIMUM WAGE

	1980	1985	1988	1989	1990	1991	1992	1993	1994[a]
				Average annual indexes (1990 = 100)					
Argentina	465.9	541.5	442.2	323.5	100.0	259.1	203.7	263.7	363.9
Bolivia		185.5	131.1	117.2	100.0	165.6	164.8	181.2	199.9
Brazil	138.4	135.0	129.9	133.1	100.0	112.8	102.5	113.0	107.4
Chile	114.4	87.3	84.5	91.3	100.0	109.3	114.3	120.0	124.4
Colombia	93.1	101.4	101.9	102.7	100.0	96.7	95.0	)7.6	96.0
Costa Rica	82.7	93.5	95.1	99.1	100.0	92.8	92.5	)2.7	93.6
Ecuador	288.3	203.6	140.5	110.2	100.0	87.0	87.1	100.0	115.9
El Salvador	287.2	190.1	125.2	106.3	100.0	97.8	101.0	<)7.8	99.8
Guatemala	207.5	195.0	157.5	141.3	100.0	80.7	72.5	<)2.8	
Haiti	136.2	124.4	129.1	120.3	100.0	84.6	71.7	i)0.3	44.3
Honduras	118.0	105.1	94.1	85.7	100.0	100.1	113.4	115.5	94.8
Mexico [c]	252.9	181.2	136.4	111.4	100.0	95.8	90.9	119.4	89.6
Panama	100.8	101.8	100.5	100.7	100.0	98.9	97.4	108.8	107.3
Paraguay	76.4	75.6	102.7	104.5	100.0	95.6	87.1	113.8	86.0
Peru[e]	428.0	232.8	222.4	107.3	100.0	68.0	68.0	47.8	61.9
Dominican Republic	153.3	122.9	133.9	119.2	100.0	101.6	123.7	117.6	125.0
Uruguay	145.0	134.8	122.2	112.8	100.0	89.6	87.4	V5.8	67.3
Venezuela	171.4	165.5	163.3	126.1	100.0	86.9	123.6	l(i6.3	116.7
				Percentage variation					
Argentina			-21.8	-26.8	-69.1	159.1	-21.4	29.5	38.0
Bolivia			6.2	-10.6	-14.7	65.6	-0.5	10.0	10.3
Brazil			10.9	2.5	-24.9	12.8	-9.1	10.2	-5.0
Chile			7.0	8.0	9.5	9.3	4.6	5.0	3.7
Colombia			-2.7	0.8	-2.6	-3.3	-1.8	2.7	-1.6
Costa Rica			-2.9	4.2	0.9	-7.2	-0.3	0.2	1.0
Ecuador			-16.0	-21.6	-9.3	-13.0	0.1	14.8	15.9
El Salvador			-5.3	-15.1	-5.9	-2.2	3.3	-3.2	2.0
Guatemala			24.2	-10.3	-29.2	-19.3	-10.2	-13.4	
Haiti			0.1	-6.8	-16.9	-15.4	-15.2	-15.9	-26.5
Honduras			-4.3	-8.9	16.7	0.1	13.3	1.8	-17.9
Mexico [c]			-11.5	-18.3	-10.2	-4.2	-5.1	-1.7	0.2
Panama			-0.4	0.2	-0.7	-1.1	-1.5	11.7	-1.4
Paraguay			10.3	1.8	-4.3	-4.4	-8.9	-3.8	2.6
Peru[e]			-12.9	-51.8	-6.8	-32.0	0.0	-2).7	29.6
Dominican Republic			3.9	-11.0	-16.1	1.6	21.8	-5.0	6.3
Uruguay			-6.4	-7.7	-11.3	-10.4	-2.5	-1J.3	-11.2
Venezuela			-15.3	-22.8	-20.7	-13.1	42.2	-14.0	9.8

Source: ECLAC, on the basis of official figures.

* Preliminary figures. [b] Minimum overall living wage with supplementary benefits. [c] Minimum wage in Mexico City, deflated by the consumer price index. [d] Minimum wage in Asunción. [e] Minimum wage in Metro] olitan Lima for non-agricultural activities. [f] National minimum wage for non-agricultural activities.

IV. THE EXTERNAL SECTOR

1. The inter Mial context

The international economy expanded in 1994, owing to the impressive recovery of growth rates in the industrialized countries following four years of slow growth, and to control of inflation, with the lowest rates seen in the past three decades. World trade expanded notably after the previous year's modest showing, while commodity prices rose significantly, in contrast to the declining trend of preceding years. This favoured Latin American exports, which consist largely of raw materials. These trends have generally continued in 1995, although the rate of growth is tending to slow.

In addition, the United States dollar fell significantly, relative to the Japanese yen and the German deutsche mark, so that the market values of those currencies reached unprecedented levels in the early months of 1995. The dollar's weakness against the yen and the deutsche mark was partially offset by its rise in value relative to the Canadian dollar and the currencies of several European and developing countries, especially the Mexican peso. Meanwhile, international interest rates rose, mainly because of the policy followed by the United States Federal Reserve Bank, although not to the levels of the previous decade. That had an adverse impact on the Latin American countries, since external debt-service payments increased. Nevertheless, as interest rates in the international financial markets continued to be low, especially as compared with those available in the Latin American and Caribbean region, investors in the developed countries continued to purchase significant amounts of Latin American currencies. Towards the end of 1994, however, financial flows to the developing countries contracted as a result of the problems that had arisen in Mexico and other emerging markets.

The world output of goods grew at a satisfactory pace (2.6%), primarily because of the recovery in the industrialised countries and the continuing expansion in tie developing countries, GDP growth in the industrialized countries was 3%, significantly higher than the 1993 figure of 1%. Me< nwhile, the developing countries again grew by more than 5% in 1994, mainly because of the headlong expansion in Asia (see table IV-1). The economies in transition contracted for the fifth year running, this time by 10%. While Eastern Europe is tending to stabilize and even grew by nearly 3%, the outlook for the ibrmer Soviet Union remained critical; its GDP dropped 15% in 1994.

The highest world-wide growth took place against a backdrop of lower inflation, since idle capacity in the developed countries had not yet been exhausted by their emerging recovery. Inflation for these countries as a whole fell from 2.9% in 1993 to 2.5% in 1994. Ii the United States inflation dropped below 3%, while in Germany it receded from 4.7% in 1993 to 3% in 1994, and in Japan it was less than 1% in 1994. In the European countries which devalued their currencies, the adverse impact on price levels was cushioned by the drop in labour costs (see table IV-2).

In the United States GDP grew at *i* robust pace, reaching 4.1% in 1994, its best performance since 1984. In the last quarter GEP grew at a seasonally adjusted annualized rate of 5.1%, thereby completing 12 quarter:; of steady expansion.

In 1995, however, this momentum has slowed, as the first quarter increase was only 2.7%. The strong expansion in 19)4 stemmed from the soaring growth of consumption, as well as increased investment. Another

Table IV-1

GROWTH OF GROSS DOMESTIC PRODUCT (GDP), BY REGION

	Growth of GDP (annual percentage change)						Memo items: comparative indicators	
	1981-1990	1991	1992	1993	1994"	1995[b]	3rowth df population 1<»85-1994 (average ar nual percentage \ ariation)	Population in 1994 (millions)
World	2.8	0.4	**0.7**	**1.0**	2.6	23/4	**1.75**	**620**
Developed market economies	2.8°	0.8	1.5	1.0	2.9	2V4	0.6	818
United States	2.6	-0.6	2.3	3.1	4.1	3	1.0	261
European Community	2.3°	0.6	1.0	-0.5	2.7	3	0.3	370
Japan	4.1	4.3	1.1	-0.2	0.6		0.4	125
Economies in transition	2.0[C]	-8.8	-15.5	-8.6	-9.9	-6	0.5	391
Eastern Europe	0.6°	-11.3	-4.7	1.0	3.8	3 3/4	0.2	99
USSR and its successor States	2.7	-8.0	-18.3	-12.0	-16.3	-11 Vi	0.6	292
Developing countries	3.1	3.4	4.9	5.0	5.4	5	2.0	4411
Latin America and the Caribbean	1.2	2.9	2.2	3.0	4.4	P/4	2.0	474
Africa	2.0	1.3	0.8	0.5	2.1	3	2.9	708
West Asia	-0.8	-0.2	5.7	2.2	0.4	13/4	3.4	152
South and East Asia	6.0	5.4	5.2	5.5	6.5	7	2.1	1784
China [e]	9.0	8.0	13.2	13.4	11.8	10	1.4	1209
Mediterranean countries	2.5	-5.6	1.4	0.1	-2.8	21/4	1.6	85

Source: United Nations, Department for Economic and Social Information and Policy Analysis.

[a] Preliminary figures. [b] Predictions based partly on the LINK project. [c] After 1991, the former German E temocratic Republic is included in Germany and, accordingly, in the European Union. Covers 93 countries which togethet account for 99% of the population of all developing countries. [e] Net material product to 1988.

contributing factor was relatively low interest rates, which between July 1992 and February 1994 were at their lowest level since 1963, although they rose in 1994. This improved the net asset position of households and enterprises, thereby enabling the debt burden to be reduced sufficiently and generating a major increase in total spending.

The marked buoyancy of the economy in 1994 evoked certain fears of a resurgence of inflationary pressures. The current Administration's austere fiscal policy achieved excellent results in reducing the budget deficit from 4% of GDP in 1992 to 3.4% in 1993 and 2% in 1994. In any event, the Federal Reserve Bank foresaw difficulties in maintaining a low inflation rate, and therefore gradually raised short-term interest rates from February 1994 onward. This, however, did not immediately affect the economic expansion, which remained very strong for the remainder of the year. Thus, interest rates rose again in February 1995, and fell thereafter, in view ol the economic slow-down that was already evident at mid-year.

The European Union expanded by 2.8%, thus recovering from its slump of the preceding year, although with continuing high levels of unemployment, approaching 11% of the labour force. Unemployment has therefore become a major source of political, economic and social concern.

In Germany, the difficulties ir volved in union with the former German Demccratic Republic

Table IV-2
MAIN ECONOMIC INDICATORS IN THE SEVEN LARGEST INDUSTRIALIZED ECONOMIES, 1993-1994

	Quarter							
	1993				1994			
	I	**II**	in	IV	I	II	**m**	IV
Growth of gross domestic product[a]								
Germany[0]	-6.4	2.3	2.6	-2.0	2.0	4.1	5.3	3.0
Canada	3.7	4.1	1.6	3.6	4.0	6.8	4.7	5.9
United States	1.2	2.4	2.7	6.3	2.3	4.1	4.0	5.1
France	-3.5	0.8	0.8	0.4	3.6	5.3	*M*	2.7
Italy	-1.3	0.9	-2.7	4.9	1.4	4.0	5.4	0.1
Japan	3.5	-2.1	1.1	-2.8	3.2	0.7	3.5	-3.4
United Kingdom	2.5	2.5	3.3	3.2	4.0	6.0	3.1	3.1
Total	**0.6**	**1.1**	1.8	2.3	3.2	3.7	**4.2**	2.3
Unemployment[0]								
Germany[0]	5.3	5.6	6.0	6.6	6.8	6.9	().9	6.8
Canada	11.0	11.3	11.3	11.0	10.9	10.6	10.1	9.7
United States	7.0	6.9	6.7	6.5	6.5	6.1	:i.9	5.5
France	11.1	11.5	11.9	12.3	12.4	12.5	1:1.5	12.4
Italy	9.1	10.7	10.3	10.7	11.7	12.5	1 .8	12.2
Japan	2.3	2.4	2.5	2.8	2.8	2.8	:i.o	2.9
United Kingdom	10.5	10.3	10.4	10.0	9.9	9.6	!>.5	8.9
Total	**6.8**	**6.9**	6.9	7.0	7.1	6.9	**(Í.8**	6.6
Consumer price increases								
Germany	7.2	4.0	1.8	2.2	5.4	2.8	1.4	1.4
Canada	3.0	0.7	1.5	1.8	1.8	1.5	:,.2	1.1
United States	3.3	3.3	1.5	2.9	2.5	2.5	•..6	1.9
France	3.0	2.6	0.8	1.9	1.8	2.2	0.7	1.9
Italy	5.0	5.0	3.5	4.2	5.5	2.7	:,0	4.0
Japan	0.0	3.5	1.9	-1.1	0.7	1.5	-1.1	2.3
United Kingdom	-2.9	6.7	1.1	1.5	0.7	7.3	(.0	2.8
Total	**2.6**	**3.6**	1.7	1.8	2.2	1.5	:,4	2.1

Source: United Nations, Department for Economic and Social Information and Policy Analysis, based on data provided by the International Monetary Fund (IMF), OECD and national authorities.

Note: Total growth rate is weighted average with weightings being gross domestic product, consumption and industrial output, as appropriate.

* Percentage change in seasonally adjusted data from preceding quarter, expressed as annual rates. In this able "Germany" means only the former Federal Republic of Germany prior to 1991. [c] Percentage of total labour force; seasonally adjusted data as standardized by OECD. Percentage change in average consumer price index in quarter relative tc same quarter of preceding year, expressed as annual rates.

continued to weigh on the economy, which led to a very awkward fiscal situation, due largely to massive transfers of resources to the new eastern states. This made fiscal austerity measures necessary and forced the Deutsche Bundensbank to adapt a cautious attitude towards the relaxation of monetary controls. However, in order to cushion the impact of the recession, short-term interest rates were gradually lowered during 1993 and the first half of 1994. After registering strong growth between 1988 and 1992, GDP slowed, and even fell by 1.7% in 1993. Be that as it may, a solid recovery process was seen during 1994. Spearheaded initially ¡>y the export sector, it spread gradually to the rest of the economy, achieving unexpectedly strong growth in the second half of the year, which facilitated the recovery in the rest of Europe.

France's economy grew by 2.5%, in contrast to the 1993 drop in GDP. However, the unemployment rate remained very high, at more than 12% of the labour force. The United Kingdom's GDP expanded by 3.8%, strengthening the recovery that had begun in the previous year, although more recently a certain slow-down has been seen, as well as the emergence of inflationary pressures.

Japan, meanwhile, has had greater difficulty in conquering the recession, as its growth continued to be slow in 1994 (0.6%), with a drop of 3.4% in the last quarter. This poor performance continued to be influenced by the adjustment process initiated in previous years as a result of falling stock prices and high levels of debt, while the rapidly appreciating yen has weakened the manufacturing sector. Despite the loosening of monetary controls and the set of economic measures adopted by the Government since the onset of the recession, private-sector spending has continued to contract markedly.

The volume of world trade expanded by 9.4% in 1994 -its highest increase in two decades and double that of the previous year. In addition, dollar prices rose by slightly more than 2%, so that the value of trade expanded by nearly 12%, thereby reaching the unprecedented figure of US$ 4 billion. The world output of goods rose by 2.6%, which was also much higher than the 1993 figure. This sizeable gap in growth between international trade and output reflects the continual integration of national economies through trade (see table IV-3).

The volume of exports increased by 8.4% in the industrialized countries and 11.8% in the developing countries. Once again, the largest increase was seen in Asia, while Latin America took second place. Meanwhile, Eastern European economies enabled this region's trade to expand after contracting in 1993. Due to the growth of GDP in the industrialized countries, their import volumes increased significantly, but the largest expansion in the global demand for imports originated in the As an developing countries.

The unit value of basic commodities, excluding oil, rose by somewhat more than 12% after five years of contraction. The unit value of manufactures grew by 2.8%, thereby recovering from the previous year's slumt> of nearly 6%. Thus, the terms of trade of the non-oil-exporting developing countries again roie slightly, this time by 0.7%, so that they continued to recover from the low levels of preceding years.

The pace of growth of th; international financial markets slowed in 1994, after the robust expansion of capital flows tha: had begun in 1991. These flows increased by 16% in 1994, whereas in 1993 they had increiised by 34%, to reach nearly US$ 820 billion. After a period of relative growth during 1990-199!!, the proportion of international capital flowing to the developing countries has stabilized and ever decreased; this is especially visible in the stock investments made by mutual funds and other investors. Bond issues by developing countries a lso decreased in the first nine months of 1994.

The slower growth of international capital flows in 1994 was due mainly to j ;reater volatility on the world financial markets, especially in the second quarter. This was reflected in smaller bond issues by both developed and developing countries, although bonds continued to represent a significant portion of total borrowing. Bond sales dropped 11% world-wide, while falling by only around 7% in the devele ping countries. Bond issues in the Latin American countries contracted to a far greater exten : (-32%), owing to the abrupt suspension of sales in Venezuela and a sharp decrease in Mexico. As a result, Latin American bond sales as a percentage of total capital flows to the developing countries fell from 45% to 33% in 1994.

While stock issues for new capital formation continued to expand, they repressed only 5.5% of total capital flows in 1994. Stock issues by the developing countries were up 50%, from US$ 12 billion in 1993 to US$ 18 billion in 1994. However, primary stock issues in the Latin American countries fell from U;>$ 5.7 billion in 1993 to US$ 4.7 billion in 1994. This was due chiefly to a sharp fall-off in issues of American Depository Receipts (ADRS) in Argentina and

Table IV-3
WORLD TRADE, 1985-1995

	1985	1986	1987	1988	1989	1990	1991	1992	1993	994[a]	1995 [b]
	Value of exports (Billions of dollars)										
World	1 889	2 064	2413	2 747	2 970	3 370	3 429	3 671	3 672	'113	4 587
Developed market economies [c]	1 281	1487	1 735	1985	2 126	2 452	2 502	2 650	2 572	::861	3 186
Developing countries	487	454	546	631	714	794	837	923	993	] 129	1 279
Economies in transition	121	127	132	131	129	124	91	97	106	122	
Eastern Europe	64	67	69	69	67	65	44	44	50	61	
Former Soviet Union	57	60	63	62	62	59	47	54	56	61	
	Volume of exports (Annual percentage change)										
World	3.7	5.5	5.0	8.8	7.3	4.4	5.6	5.7	5.3	9.4	7.1
Developed market economies [c]	4.7	2.4	4.4	8.7	7.4	5.1	3.8	4.4	3.0	8.4	6.5
Developing countries	1.0	17.5	7.5	10.0	8.9	4.6	11.3	9.6	11.7	11.8	8.6
Economies in transition	-0.8	4.0	2.4	4.5	-1.5	-9.5					
Eastern Europe	2.1	-0.7	1.7	4.3	-2.9	-6.2	-9.3	-0.1-	0.3	19.1	
Former Soviet Union	-4.3	10.0	3.4	4.8	0.0	-13.1					

Source: International Monetary Fund (IMF), *International Financial Statistics* (various issues), and estimates prepared by the United Nations Department for Economic and Social Information and Policy Analysis.
' Preliminary estimates. Estimate. [c] After 1991, the former German Democratic Republic is included in Germany and, accordingly, in the European Union.

Mexico, which were only partially offset by a significant increase in Chile.

Mention should also be made of the growing importance of syndicated loans, which continued to expand in 1994 (by more than 10%). Likewise, non-underwritten facilities, primarily Eurocommercial paper and other medium-term commercial paper, grew vigorously. Brazil is among the Latin American countries that have resorted most extensively to this type of financing.

The smaller capital flows in 1994 were influenced not only by these problems in the developing countries, but also by higher interest rates in the United States. The Federal Reserve Bank's discount rate was raised six times in 1994, reaching 4.8% in December 1994 and 5.25% in February 1995, whereas it had been only 3% in 1993. In other developed countries, however, interest rates generally declined. In Germany the discount rate fell from 5.8% in 19i>3 to 4.5% in mid-1994; in March 1995 the Bundesbank lowered the rate again, to 4%. In the United Kingdom short-term financial market rates fell during the first half of 1994, but rose again towards the end of the year. In France the decline in short-term financial market rates that had begun in the previous year continued, bringing these rates to around half their 1!»92 level. In Japan short-term rates dropped by 1 % in 1994, to hold steady at slightly more than 2%, their lowest level in many years. The rediscount rate, which had been around 1.75% since September 1993, was brought down to only 1% in Ar. ril 1995 (see table IV-13).

Meanwhile, in the developed countries, higher inflationary expectations caused long-term interest rates to rise, especially in the

United States, where they were up by more than two percentage points during 1994. In Germany long-term rates mounted again, after falling during the first quarter of 1994, a trend also seen in France, the United Kingdom and Japan.

The liberalization of world markets continued to make steady gains. The new General Agreement on Tariffs and Trade (GATT) was signed in January 1994, following protracted bilateral negotiations between the United States and the European countiies; as a result, the World Trade Organization (WTO), the new institution which replaced GAIT, segan operating in 1995. The North American Free Trade Agreement (NAFTA) entered into force at the beginning of 1994 and could soon be expanded to include Chile; the negotiation s for this began in 1995.

2. Foreign trade

The region's external sector expanded again to some extent and thus did not constitute a constraint on the growth of most Latin American and Caribbean economies. Deficits were seen again in both merchandise trade and the current account, although these could be financed relatively easily owing to the continuation of abundant capital flows from abroad. Export growth in 1994, while significant, was not sufficient to offset a new and accelerated growth of imports. Thus, the merchandise trade deficit of the Latin American countries expanded by US$ 4.5 billion. Be that as it may, at only slightly more than 1% of regional GDP, the merchandise trade deficit remained low.

Meanwhile, the current-account deficit also continued to expand, representing around 3% of GDP for the region as a whole. Contributing to this outcome, in addition to the increase in the merchandise trade deficit, was the US$ 1.2 billion growth in net payments of interest and profits.

One significant change in Latin American and Caribbean foreign trade in recent years has been the growing importance of intraregional trade. Since 1990, intraregional flows have expanded notably, increasing from 13% to 22% of total regional trade during that period. The bulk of intraregional trade flows were between Southern Common Market (MERCOSUR) countries and between these countries and Chile.

In 1994 trade between the MERCOSUR countries continued to expand rapidly (19%), although less so than in the previous three years. The factors that especially influenced this growth included the deregulation of their economies, liberalization of their trade relations and a higher demand for imports in all of the countries that are parties to the subregional agreement, as well as major increases in the domestic availability of goods. In particular, the remarkable growth of demand in Brazil, whose MERCOS UR imports rose by 40%, made a significant contribution. While this had a widespread impact, its chief beneficiaries were non-traditional exports. The buoyancy of Brazilian demand continued into the early months of 1995.

Bilateral automotive-sector agreements between MERCOSUR partners were also influential. Thus, Argentina's automobile sales to Brazil increased significantly, while two thirds of the total increase in Uruguay's exports were due chiefly to higher motor vehi cle sales within the framework of such bilateral agreements. Trade between the MERCOSUR countries as a percentage of their trade win all countries increased only slightly, given the dramatic increase -linked primarily to high capital flows- in these countries' imports from the rest of the world. That percentage remained very high in Paraguay and Uruguay (42% and 48%, respectively), while in Brazil it was only 14%, despite having risen substantially in recent years, and in Argentina, it was 27%.

Chile's exports to Latin America and the Caribbean, which were dominate :d by sales to the MERCOSUR countries, rose by over 30%. Exports to Asia also expanded by 30%, while those to North America grew by 21%, and to the European Union, by only 12%. If copper is excluded, the growth in Chilean sales to the region amply exceeded its sales to other geographical areas.

Intraregional trade flows hav; been important for the Andean Group countries also. For instance, Venezuela continues t) be Colombia's

Table IV-4

LATIN AMERICA AND THE CARIBBEAN: VARIATIONS IN EXPORTS AND IMPORTS OF GOODS

(Growth rates)

	Exports"			Imports[3]		
	Value	Volume	Unit value	Value	Volume	Unit value
	Latín America and the Caribbean					
1980-1984°	2.0	5.4	-3.3	-8.3	-6.4	-2.0
1985	-5.8	0.4	-6.1	0.8	2.4	-1.7
1986	-15.5	**-2.0**	-13.9	2.0	7.7	-5.2
1987	14.1	7.2	6.6	12.6	6.2	5.9
1988	14.1	10.5	3.2	14.1	9.0	4.7
1989	9.8	**4.0**	5.7	7.3	1.3	6.0
1990	9.7	6.1	3.3	13.0	7.7	4.7
1991	-0.8	5.2	-5.6	18.3	17.4	0.9
1992	5.3	7.4	-2.1	22.9	20.2	2.2
1993 .	5.4	6.6	-1.1	8.9	9.3	-0.4
1994 [d]	15.4	8.3	6.5	17.0	12.5	3.9
	South American countries [e]					
1980-1984°	0.6	3.6	-2.9	-9.1	-6.9	-2.3
1985	-4.7	4.0	-8.3	-5.5	-3.9	-1.7
1986	-14.8	**-3.3**	-11.8	9.2	17.4	-6.9
1987	12.3	6.0	5.9	14.3	6.2	7.5
1988	20.1	12.6	6.8	6.8	2.7	4.0
1989	9.9	4.7	4.8	-1.4	-7.9	6.9
1990	7.6	6.7	0.8	9.1	5.0	3.9
1991	-2.0	4.3	-6.1	17.3	19.9	-2.2
1992	5.7	**8.7**	-2.8	21.0	17.6	2.9
1993 ^	4.1	7.8	-3.4	14.7	17.3	-2.3
1994 [d]	16.0	8.3	7.1	16.5	12.0	4.0
	Mexico					
1980-1984 [c]	-9.3	14.7	-4.7	-8.9	-7.2	-1.8
1985	-10.5	**-9.2**	-1.4	19.5	23.1	-3.0
1986	-25.4	2.7	-27.4	-14.5	-12.4	-2.4
1987	26.8	10.2	15.1	7.0	4.1	2.8
1988	0.3	7.6	-6.8	52.4	41.8	7.4
1989	11.2	**1.9**	9.1	25.5	21.8	3.0
1990	17.5	4.2	12.8	22.9	13.7	8.1
1991	0.1	7.6	-7.0	22.1	16.3	5.0
1992	2.5	3.0	-0.5	26.2	25.0	0.9
1993 A	9.1	2.8	6.2	1.5	-2.8	4.5
1994 [d]	15.1	9.6	5.0	20.4	16.3	3.5
	Central American and Caribbean countries					
1980-1984 [c]	-4.1	-2.4	-1.7	-3.1	-2.2	-1.0
1985	-0.9	1.7	-2.5	2.3	2.1	0.2
1986	9.3	-5.2	15.2	-0.9	-0.3	-0.5
1987	-0.5	8.0	-7.8	12.8	9.5	3.1
1988	2.6	0.5	2.1	-3.6	-7.1	3.8
1989	5.8	3.3	2.4	12.6	5.6	6.6
1990	8.1	7.1	0.9	7.1	6.0	1.0
1991	9.4	6.3	2.9	13.0	8.4	4.4
1992	10.0	10.1	0.0	21.6	20.2	1.1
1993,,	6.9	7.1	-0.2	4.5	4.7	-0.2
1994 [d]	10.9	3.8	6.9	9.3	4.2	4.9

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

" Excludes the maquiladora industry in Mexico. [b] Covers 17 Spanish-speaking countries, plus Brazil and Hait. [c] Average. [d] Preliminary figures. [e] Includes Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Paraguay, Peru, Uruguay and Venezuela. Includes Costa Rica, the Dominican Republic, El Salvador, Guatemala, Haiti, Honduras, Nicara gua and Panama.

most important export trade market. Ecuador's exports to the Andean Group countries, especially Colombia, registered high growth rates; the same was true of its sales to other Latin American countries, particularly Chile and Mexico. Meanwhile, the bulk of the increase in Ecuadorian imports stemmed from Andean Group countries, as well as from Brazil and Mexico.

Trade between the Central American countries has recovered significantly in recent years, following the sharp contraction seen during the 1980s. Thus, Guatemala's sales to Central America expanded (13%), while Costa Rica's manufacturing industry has benefited from the recovery of demand in the subregion. In Honduras, trade with other Central American countries has intensified since a free trade zone was established in April 1993; exports rose 25%, which was similar to the previous year's rate. In El Salvador, however, in contrast to 1993, exports of non-traditional products to Central America grew more slowly than trade with the rest of the world, which increased its deficit with the Central American Common Market (CAO*!); likewise, El Salvador's trade surplus with Honduras and Nicaragua decreased, while its traditional deficit with Guatemala and Costa Rica deepened in 1994.

The first year of operation of the North American Free Trade Agreement (NAFTA) was characterized by a significant expansion in Mexico's merchandise trade with other NAFTA members; its overall trade with the United States grew 22%, and with Canada, 14%.

Several countries saw major increases in income from the maquiladora (in-bond assembly) industry or free-zone activities. In Mexico the added value generated by maquilas grew by more than 9% in real terms, but was lower than the preceding year's 15%. Central America and Cuba again had sizeable income from this source. In El Salvador, the maquiladora industry continued to exhibit great dynamism, which helped to maintain the rate of growth of manufacturing output. Maquila exports reached US$ 430 million in absolute terms (US$ 140 million more than in 1993), while imports of spare parts and components rose from US$ 203 million to US$ 298 million in 1994. Guatemala's sales of maquiladora textiles and nothing to the United States climbed from US$ 118 million to US$ 131 million.

In Honduras the maquiladon industry has grown rapidly since 1991, neaily tripling its added value in current terms. However, in 1994 its growth rate decreased beca ase of labour problems. In Nicaragua, too, it giew at a robust pace. The gross value of exports from the Mercedes Industrial Free Zone 'vas US$ 37.3 million, easily triple the level achieved in 1993. In Costa Rica, however, the maquiladora industry stagnated to some exten as a result of the transfer of some enterprises to other Latin American countries with lower labour costs. In Bolivia, the outstanding growtr of jewellery exports was associated with maquiladora enterprises. In Panama, re-exparts from the Colón Free Zone (which are counted as exports) expanded by 11%, which meant total sales of over US$ 5 billion, stimulated by the opening of Latin American and Caribbean markets. In 1994 new markets in Brazil and Ecuador played a leading role.

a) Merchandise exports

The value of the region's merchandise exports was up by 16% in 1994, to US$ 181 billion, which denoted an accelerated expansion after the moderate increase of the previous three-year period. The increase was attributable to the expansion of the volume of exports and, to a lesser extent, of unit values (see table IV-5).

Export trends in the region were also quite uniform, since nearly all counxies achieved substantial growth. Seven countr.es (Argentina, Bolivia, Chile, the Dominic in Republic, Ecuador, Nicaragua and Peru) expanded by 20% or more, but there were difference s in the relative contributions of volumes and prices. In the Dominican Republic, Ecuador and Peru, the higher export values were due 1o increases in both prices and volumes. Peru's e sports grew by 30%, while Ecuador's exports recovered impressively from the previous ye ir's slump, and the value of the Dominican Republic's merchandise exports rose 25%. Meanwhile, in

Chile and Nicaragua, the increase stemmed mainly from prices, although volumes also increased significantly. In Chile, the value of exports expanded by 25%, after contracting in the previous year. There was thus a return to the expansionary course of recent years, with an average annual rate of 12% between 1985 and 1992. Nicaragua pursued the robust recovery that had begun in the previous year, after the slump that had lingered since the start of the 1980s. Meanwhile, in Bolivia, whose exports exceeded US$ 1 billion for the first time, the opposite occurred, since volumes grew more than prices, notwithstanding significant price growth (13%). In Argentina, however, unit values increased by only 2%; therefore, the expansion was due almost entirely to the spectacular growth in volumes, which denoted a recovery from the modest results of preceding years.

Another nine countries increased their exports by between 10% and 19%. In Brazil and Uruguay, the increases in unit values and volumes were roughly the same. In another four countries -Colombia, Costa Rica, El Salvador and Guatemala- the substantial rise in unit values was the main determinant; indeed, for several of these countries, it was the only one, since their volumes contracted or barely grew. The rise in unit values was due chiefly to the steep climb in international coffee prices. In Colombia and Guatemala, export trends improved as compared with the previous year, while Costa Rica's growth rate remained the same. In El Salvador, export growth, while high, was lower than in the preceding year (see table IV-5).

In the remaining three countries, Mexico, Panama and Venezuela, the increase in volume was the decisive factor in export growth; in Mexico and Venezuela, unit values were affected by the downward trend in oil prices. In Mexico, the value of exports rebounded significantly, growing by 17%, whereas in the previous year it had increased by 12%, and in 1992, by 8%. Exports of Panamanian products continued to increase slowly, while re-exports climbed more rapidly, thanks to the Colón Free Zone's trade boom. Venezuela's non-oil exports expanded by 10%, as a result of favourable external demand and depressed domestic demand, while oil exports expanded because of higher volumes of sales abroad.

In Honduras and Paraguay, exports grew moderately, since the contraction in volumes counteracted the favourable effsct of the rise in prices. Honduras's merchandise exports increased by 3%, owing to an f % increase in prices, since their volume fell by 5%. Paraguay's exports grew by i'<%, owing to better prices, which amply offsît the drop in shipped volumes. Lastly, Haiti was the only country in which the value of exports declined, falling by over 40% as a result of the continuation of the trade embargo during nearly all of 1994. Thus, Haiti's foreign sales declined to only one quarter of th ;ir value three years earlier.

The expansion of Latin American exports in 1994 was driven both by primary products and by manufactures and non-traditional products, although with different characteiistics in each country. This was facilitated by higher demand in the international and regional markets, as well as by major increases in the domes ic availability of goods. On the other hand, the ev olution of real exchange rates had a contrary eïect, slowing export growth. As noted in chapte :: II, several of the region's countries had shown significant declines in real exchange rates in recent years, which undoubtedly affected the competitiveness of their exports. In 1994 this factor had more of an impact on non-traditional products, since for primary products, the effect of falling exchange rates was partially or wholly offset by the widespread rise in international commodity prices.

The expansion of commodity exports was due especially to the rise in the prices of major products. Thus, higher coffee prioes benefited Brazil, Colombia and the Cential American countries. The rise in metals prices helped to expand Chilean and Peruvian exports, while the increases in cellulose and wool prices were important for Chile and Uruguiy. In some countries, commodity export valûmes also increased, although not as much a¡; prices. This was true for Argentina, where only volumes increased, while in Bolivia, Chile and Peru, the volume increases came in addition to steep rises in metals prices.

Table rV-5

LATIN AMERICA AND THE CARIBBEAN: EXPORTS OF GOODS FOB [l]

(Indexes: 1980 = 100 and growth rates)

	Value				Unit value				V jlume			
	In-dex 1994[b]	Growth rates 1992	1993	1994[b]	In-dex 1994[b]	Growth rates 1992	1993	1994[b]	In-dex 1994 [b]	Growth rates 199::	1993	1994[b]
Latin America and the Caribbean	**175**	5.3	**5.4**	**15.4**	80	•2.1	-1.1	**6.5**	**220**	7.4	**6.6**	8.3
South American countries	**167**	**5.7**	**4.1**	**16.0**	**79**	-2.8	-3.4	**7.1**	**212**	**8.''**	7.8	8.3
Argentina	196	2.1	7.2	20.0	84	1.7	2.0	2.0	233	0.4	5.1	17.7
Bolivia	105	-20.0	16.7	38.8	59	-18.0	-6.6	13.2	177	-2.4	24.9	22.6
Brazil	216	14.2	7.4	12.3	81	-3.6	-2.0	6.4	268	18.,'i	9.6	5.5
Chile	245	11.9	-7.9	25.4	92	-5.0	-10.7	15.5	267	17.''	3.2	8.6
Colombia	215	-3.3	2.3	15.4	95	-10.4	-4.4	17.0	227	8.0	7.0	-1.4
Ecuador	148	5.5	1.8	21.4	58	-1.4	-3.9	11.0	255	7.0	5.9	9.4
Paraguay	435	-3.5	-52.8	5.2	121	-1.0	4.0	9.0	359	-2.:i	47.0	-3.5
Peru	115	4.7	-0.6	30.0	99	-1.2	-8.0	14.0	116	5.<)	8.0	14.0
Uruguay	181	6.1	-3.4	16.3	95	-0.6	-5.1	7.5	190	6.:S	1.8	8.2
Venezuela	82	-6.5	0.2	12.0	59	-3.0	-6.2	1.5	141	-3.7	6.9	10.3
Mexico	**223**	**2.5**	**9.1**	**15.1**	**77**	-0.5	**6.2**	**5.0**	**291**	**3-D**	2.8	**9.6**
Central American and Caribbean countries	**147**	**10.0**	**6.9**	**10.9**	**110**	**0.0**	-0.2	**6.9**	133	**10.1**	**7.1**	3.8
Costa Rica	216	16.1	11.8	11.2	85	-2.0	1.2	8.0	253	18.4	10.5	2.9
El Salvador	76	1.6	22.5	11.8	98	-4.0	2.5	21.0	77	*5.1*	19.5	-7.6
Guatemala	100	4.4	5.6	12.5	96	-6.0	2.5	10.0	105	11.')	3.1	2.3
Haiti	24	-55.2	17.8	-39.5	68	-8.8	2.1	10.0	35	-50.)	15.4	-45.0
Honduras	102	-0.2	1.5	2.5	99	-2.0	2.3	8.0	103	1.5	-0.7	-5.1
Nicaragua	76	-16.8	19.7	28.7	75	-28.9	15.0	21.0	102	17.1	4.1	6.3
Panama	258	20.9	5.7	10.2	151	2.0	-3.0	0.0	170	18.5	9.0	10.2
Dominican Republic	66	-14.6	-9.1	24.5	71	-6.7	-5.3	11.7	93	-8.5	-3.9	11.5

Source: ECLAC, on the basis of figures from the International Monetary Fund (IMP) and national sources.
[a] Excludes the maquiladora industry in Mexico. [b] Preliminary figures.

In several countries there was a sizeable increase in exports of manufactured and non-traditional products. In Mexico, in particular, high-technology industries, and, to a lesser extent, certain producers of intermediate inputs and traditional end-user industries, fared remarkably. Argentina saw a continuation of the sharp upward trend in manufacturing exports, especially vehicles, propelled by the special regime in the automotive sector, while the growing demand from Brazil stimulated foreign sales of various products. Non-traditional exports from Chile, Colombia, Ecuador and Peru increased at a robust pace (between 13% and 28%), despite the real appreciation in their respective currencies. Uruguay's non-traditional expor:s expanded by 11%, due also to increased purchases by Brazil in the wake of the Real Plan. Likewise, Bolivia's non-traditional exports, especially jewellery articles, expanded considerably, thereby exceeding traditional exports ind displacing mining products. Venezuela's non-traditional exports grew by 33%, stimulates by the drop in domestic demand.

In El Salvador, non-traditional exports were up 14%, led by increased sales of footwear, processed food products and detergents to the Central American countries, and of bed linens, tableware and kitchenware outside the region.

Such exports also rose satisfactorily in Guatemala (10%) and Nicaragua, where they already constituted one third of total merchandise sales. In Panama, where non-traditional exports already accounted for 40% of the total, they rose 12%, owing to increased sales of medicines, banana pulp, cowhides and processed shellfish.

In Brazil, on the other hand, exports of manufactures performed differently than in the rest of the region, sales of such products increased only moderately, owing to the expansion of the domestic market and the strong overvaluation of local currency. Nevertheless, exports of semimanufactures increased by 26% as a result of price increases. In Costa Rica, too, non-traditional exports performed poorly, in contrast to the vigorous expansion seen in previous years; they were held in check during most of the year, especially by a somewhat overvalued exchange rate.

While oil-exporting countries were affected by the unfavourable trend in international crude oil prices, they all managed to offset this situation easily through higher sales of other products, either because of better prices or growth in the volume of exports. In addition, Venezuela managed to expand its exports by increasing shipped volumes (from 1.5 million to 1.7 million barrels per day), so that the value of oil exports increased by 6% as compared with the previous year.

Colombia's oil exports fell 11% as a result of the drop in both volume and prices. Pending the expansion of shipped volumes of crude from the Cuisiana oil fields, petroleum slipped below coffee as the leading export product in 1994. In Ecuador, low oil prices were offset by an increase in shipped volumes, so that the total value of oil exports rose slightly. Mexico's oil exports fell 1% as a result of poor prices and the stagnation in shipped volumes of crude. In Argentina, however, they grew notably, thereby accounting for a significant share of its total foreign sales.

b) **Merchandise imports**

The value of Latin American and Caribbean merchandise imports increased again for the fifth consecutive year; this time it grew by almost 18%, to reach US$ 196 billion, with an increase of 12% in volume and nearly 4% in unit value (see table IV-6). In most countries the expansion was facilitated and even stimulated by abundant capital flows. In all countries, unit values exhibited similar growth, of bei ween 3% and 4.5%. Moreover, the only major îegional import which declined was petroleum ind petroleum products.

The largest import growth was seen in Argentina, Brazil, Colombia, Ecuador, El Salvador, Mexico, Peru and Uruguay, with increases of between 18% and 39% as compared with 1993. In all these countries import growth accelerated in 1994; in several of them, it did so remarkably, except in Colombia, where it slowed, following a sharp rise during the previous two-year period. Around 90% of the total regional increase was due to liigher imports in three countries: Mexico (USB 10 billion); Brazil (US$ 7.5 billion); and Argentina (US$ 4.3 billion).

Imports also expanded by between 7% and 11% in Chile, Costa Rica, tin; Dominican Republic, Guatemala, Nicaragua, Panama and Paraguay. Imports by Guatemala and the Dominican Republic increased more rapidly than in 1993, while the remaining five countries saw a clear deceleration in imports, having registered spectacular growth rates in the preceding years.

In Bolivia imports were virtu illy stagnant, which was attributable to decreases in volume, since unit values climbed moderately. Meanwhile, in Haiti, Honduras and Venezuela, imports contracted as a result of balance-of-payments problems and ai economic recession. Venezuela's imports slumped, decreasing by US$ 3.4 billion, or more than double the contraction seen in 1993. This was attributable to the institution of foreign exchange controls, in addition to the recessfoi. and an acute banking crisis (see table IV-6).

In Honduras, the current valu; of imports decreased 4%, owing to the continui ng recession. Lastly, in Haiti, imports slumped again due to the political crisis, after recovering partially in the previous year, so that imports amounted to less than half the 1990 figure. The lifting of the embargo in November 1994 made it possible to

Table IV-6

LATIN AMERICA AND THE CARIBBEAN: IMPORTS OF GOODS FOI **J**[a]

(Indexes: 1980 = 100 and growth rates)

	Value				Unit value				Volume			
	In-dex	Growth rates			In-dex	Growth rates			In-dex	Growth rates		
	1994[b]	1992	1993	1994[b]	1994[b]	1992	1993	1994[b]	1994[b]	19' *n*	1993	1994[b]
Latin America and the Caribbean	**193**	**22.9**	**8.9**	**17.0**	**111**	**2.2**	-0.4	**3.9**	**175**	2C.2	**9.3**	**12.5**
South American countries	**160**	**21.0**	**14.7**	**16.5**	**104**	**2.9**	-2.3	**4.0**	**155**	**17.6**	17.3	**12.0**
Argentina	212	81.0	13.6	27.9	135	2.1	-1.5	3.0	156	77.3	15.3	24.1
Bolivia	195	29.4	6.8	0.9	107	3.1	1.2	4.0	182	2Í.6	5.6	-3.0
Brazil	144	-2.2	24.9	29.0	90	-1.1	-4.0	3.0	160	-1.1	30.1	25.2
Chile	199	25.6	10.2	6.9	110	1.6	-2.2	3.5	182	22.6	12.7	3.2
Colombia	255	32.6	50.7	20.0	104	1.1	-1.2	3.0	246	31.1	52.4	16.5
Ecuador [c]	146	-5.6	18.8	32.3	102	0.0	14.4	15.0	144	-Í.6	3.8	15.0
Paraguay	423	4.4	37.0	7.0	80	2.9	-1.0	2.9	531	1.5	38.3	4.0
Peru	182	15.9	-0.2	38.8	131	0.3	-0.1	2.3	139	1Í.5	-0.1	35.6
Uruguay	155	25.5	9.4	22.0	95	0.0	-7.0	2.0	163	2Í.4	17.6	19.7
Venezuela	71	25.5	-12.6	-30.7	97	1.0	-1.6	4.1	73	2¿,2	-11.1	-33.4
Mexico	**304**	**26.2**	**1.5**	**20.4**	**122**	**0.9**	**4.5**	**3.5**	**250**	2Í.0	-2.8	**16.3**
Central American and Caribbean countries	**178**	**21.6**	**4.5**	**9.3**	**121**	**1.1**	-0.2	**4.9**	**148**	2(.2	4.7	**4.2**
Costa Rica	205	30.2	18.1	7.8	91	-0.3	-0.7	4.2	225	3(.6	18.9	3.4
El Salvador	233	20.5	13.4	18.3	150	1.5	-2.1	4.0	156	IS.7	15.8	13.8
Guatemala	173	39.1	2.3	6.9	103	1.2	0.3	4.6	167	3'/.5	2.0	2.2
Haiti	44	-34.4	9.1	-34.4	110	0.4	0.0	4.0	40	-3¿,7	9.1	-36.9
Honduras	106	8.5	-4.7	7.4	80	0.6	-6.9	3.5	134	7.9	2.4	3.8
Nicaragua	89	12.0	-14.5	8.9	123	3.0	5.6	4.0	73	*i.S*	-19.0	4.7
Panama	228	18.8	4.4	10.9	152	2.6	2.7	5.0	150	If .8	1.7	5.6
Dominican Republic	189	25.8	-2.6	7.4	126	2.2	-1.1	3.8	119	22.1	-1.5	3.6

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

[a] Excludes the maquiladora industry in Mexico. Preliminary figures. [c] Problems with coverage am 1 time of registration mean that the unit values for 1993 and 1994 are not comparable to those arrived at in previous years or to th< »se of other countries in the region, ECLAC estimates indicate that the unit value growth rates for 1993 and 1994 are -1.3 and 4.0,

reverse that trend, especially because international assistance resumed.

Almost all major import categories participated in the regional boom, except fuels, which declined as a result of falling oil prices. Capital goods imports showed great dynamism, driven by the sharp upturn in investment in several of the region's countries. Argentine, Brazilian and Peruvian imports played a leading role, increasing by around 50%, as did those of Colombia, El Salvador and Mexico, which increased by between 18% and 30%. Ecuadorian and Uruguayan imports also expanded, although at a slower pace than total imports. In Honduras, capital goods imports grew 7% because of purchases of electricity-generating plants, ii order to cope with the emergency that thî country was facing. In Bolivia, Guati:mala, Haiti, Nicaragua and Venezuela, however, imports contracted. In Haiti and Venezi ela the declines were attributable to the gem¡ral difficulties affecting imports.

Foreign purchases of consumer and intermediate goods also expanc led significantly and declined only in countri es where total imports fell. In some countries, automobiles, in particular, were imported in higi numbers.

The strong growth of imports in 1994 can be explained chiefly by a combination of three factors: the sharp increase in the level of activity and investment, the real appreciation in local currencies and the liberalization of imports. An additional factor would have to be foreign capital flows, although their impact is also reflected in the evolution of real exchange rates.

All countries whose level of activity and capital formation expanded also showed an increase in imports. The converse was seen in the countries in recession, where imports also contracted. Bolivia was a special case, since despite satisfactory growth, investment declined, so that imports fell.

Falling real exchange rates undoubtedly had a marked influence on the sizeable expansion of imports in Brazil, Colombia, Ecuador, El Salvador and Peru. Meanwhile, ii; another three countries -Argentina, Mexico and Uruguay- low real exchange rates also helped to stimulate imports, even though the rates remained stable or increased. In four countries -Chile, the Dominican Republic, Guatemala and Nicaragua- exchange rates also appreciated, but imports increased more moderately, although with an elasticity relative to CIDP that was substantially higher than 1.

The liberalization of impor s proceeded largely through integration agreements, especially in the MERCOSUR countries, and through NAFTA in Mexico. In Brazil, the deregulation of trade carried out in previous years and the tariff reductions instituted to check inflation as part of the stabi lization plan, also contributed to the sharp increases in imports.

3. **Export prices and the terms of trade**

After declining for four years in a row, the dollar prices of most of the region's main export commodities rose in 1994. However, despite this recovery, the real prices of all products except bananas were substantially lower than in 1975 and 1976, which are regarded as relatively normal years, in that they preceded the huge fluctuations which began at the end of the 1970s.

The prices of primary products had deteriorated considerably during the early years of the 1980s, at a time when the world economy was passing through a recessionary phase. Subsequent recoveries took place, although in general only partial ones, at times when the dollar lost value, especially during 1987-1989. During the world economy's most recent recessionary phase, between 1990 and 1993, such prices again fared unfavourably. With the recent revitalization of the world economy, the prices of primary products, with few exceptions, increased significantly.

An outstanding example in 1994 was the rise in coffee prices, whose average annual value easily doubled as compared with 1993. The prices of lead, cotton, wool, cocoa, copper and sugar also rose significantly. However, those of meat, iron ore, oil and, to a lesser extent, soya, decreased.

The notable increase in coffee prices in 1994 was due mainly to the decreased international supply because of frosts in Brazil. Prices reached their highest level in October, to fall sharply thereafter, but in any event, their a\erage annual value was very high. Nevertheless, as a result of the price drop, the main producer countries (the Central American countries, Colombia and Brazil) agreed on a coordinated coff se marketing plan.

The rise in sugar prices that ha *i* begun two years earlier continued, while cctton, cocoa, cellulose and wool showed sizeable increases. Metals prices also rose, particularly for copper, which recovered significantly after the previous year's drop, driven by the replenishment of stocks, and lead, which also increased sharply following a significant déclins in 1993. Smaller increases were seen in the prices of other metals, notably tin and zinc, Lastly, oil prices fell again.

Trends in real commodity pricîs -i.e., the ratio of their nominal prices to those of manufactured products- have been distinctly unfavourable in the past 20 years. This was partly because the unit value of exports of manufactures from the industrialized countries more than doubled between 1975 and 1994. The rise in commodity prices in 1994 was substantially higher, in general, than for manufactures, but this barely affected the unfavourable trends for the region in the long term (see table IV-7 and figure IV-1).

Accordingly, the real prices of almost all primary products were lower in 1994 than in 1975-1976. The most unfavourable prices were those of sugar, cocoa, tin, maize, soya and wheat, which were between 50% and 70% lower than in the earlier two-year period. A considerable deterioration of between 25% and 50% was also seen in the prices of cotton, coffee, meat, copper, wool, lead and zinc. The same was true of oil prices, which, however, followed a different path. Between 1979 and 1985, oil prices had been much higher than in 1975-1976, but from 1986 onward they clearly showed a declining trend.

The region's terms of trade increased by 2.4% in 1994, due to the 6.5% increase in the unit value of exports, which exceeded that of imports (3.9%). These terms, however, were 9% lower than in 1990 and 30% lower than in 1980 (see table IV-8). The terms of trade increased in 1994 in most of the region's economies, decreasing only in Argentina, Ecuador and Panama.

The largest increase in the terms of trade was seen in Colombia, because of the substantial rise in coffee prices, despite the effect of low hydrocarbons prices on these terms. Meanwhile, the rise in metals prices made possible a significant improvement in the terms of trade for Bolivia, Chile and Peru. The Central American countries also benefited from the steep rise in coffee prices, as well as the drop in international oil prices, since all these countries are highly dependent on hydrocarbons imports.

Brazil's terms of trade improved as a result of the rise in coffee prices and :hose of other primary or semi-industrialized pioducts, such as orange juice and cocoa, while at the same time, as a net importer, the country jenefited from falling fuel prices. Uruguay showed major gains, mainly because of the recovery if wool prices. In Mexico and Venezuela, however, less favourable trends were seen, given the scant increase in the unit values of exports, which was attributable chiefly to low international oil prices.

The purchasing power of the region's merchandise exports (defined as the volume of exports adjusted for the terms of trade, which is the same as the value of exports deflated by the unit value of imports) increases 12%, slightly more than the growth in volume, given the moderate recovery in the average regional terms of trade (see table IV-9).

The expansion in the purchasing power of exports was widespread, occurring in 17 of the 19 countries analysed (purchasing power fell only in Haiti and remained stable in Honduras) and increasing significantly in most of them. There were, however, differences as to the determining factor in the expansion. In six countries (Argentina, Ecuaior, Mexico, Panama, Paraguay and Venezuela), the increase was almost wholly attributable to growth in the physical volume of exports. In Bolivia, Brazil, the Dominican Republic, Peru and Uruguay, the expansion stemmed chiefly from higher volumes, although the terms of trade also increased significan ly. In another four countries (Chile, Costa Rica, Guatemala and Nicaragua), it was due to a significant recovery in the terms of trade. Ir Colombia and El Salvador, the expansion in [he purchasing power of exports was attributable to the dramatic rise in coffee prices, while the volume of exports contracted.

4. **The balance-of-payments current account**

The deficit in the merchandise trade balance widened by 43% in 1994 to reach US$ 14.7 billion, thus capping three years of deterioration, from a US$ 13 billion surplus in 1991 to a US$ 5.6 billion deficit in 1992 and a US$ 10.3 billion deficit in 1993. The 1994 deficit would

Table IV-7

LATIN AMERICA AND THE CARIBBEAN: PRICES OF MAIN EXPORT PRODI CTS

(Dollars at current prices and growth rates)

	Annual average price					Annual growth rates		
	1980-1984	1985-1989	1990-1992	1993	1994[a]	1992	1*193	1994[a]
Unrefined sugar	13.5	8.0	10.2	10.0	12.0	1.0	13.6	19.7
Bananas	19.2	22.4	25.9	31.4	33.9	-8.1	35.6	7.9
Cocoa	99.2	83.1	53.9	50.7	63.3	-8.1	1.9	24.8
Coffee (mild) [b]	139.6	138.5	79.3	69.9	148.5	-25.1	*19*	112.5
Beer	111.9	106.3	115.8	118.7	105.8	-7.9	5.6	-10.9
Fish meal[c]	430.2	387.2	457.3	365.0	376.0	0.8	-24.3	3.0
Maize	171.6	126.8	132.2	141.7	143.6	-2.4	5.7	1.3
Soybeans [c]	278.6	245.6	241.0	255.0	252.0	-1.7	Ü.1	-1.2
Wheat[c]	165.4	136.8	139.0	142.0	151.0	17.1	-Ó.0	6.3
Cotton	83.5	66.0	75.4	62.2	82.2	-23.2	-0.6	32.1
Wool [b]	162.9	174.1	132.6	116.0	145.1	3.6	-Ú.1	25.1
Sr	73.4	90.9	110.2	86.7	104.9	-2.4	-UÍ.2	20.9
	6.3	3.7	2.7	2.3	2.5	10.8	-l:i.3	7.0
Iron ore [c]	24.1	25.5	31.9	28.1	25.5	-4.9	-1.0	-9.5
Lead/'	27.7	24.7	28.9	18.5	24.9	-2.9	-24.8	34.5
Zinc"	42.1	52.6	61.9	46.1	48.5	10.6	-2:.i	5.2
Crude oil [e]	32.1	18.0	19.5	16.1	15.5	-0.5	-i;.5	-4.0

Source: United Nations Conference on Trade and Development (UNCTAD), *Monthly Commodity Price Bull'tin*. Supplement 1970-1989 (TD/B/C.l/CPB/L.101/Add.l), Geneva, November 1989; and *Monthly Commodit] Price Bulletin* (TD/B/CN.1/CPB/L.22), vol. XV, No. 1, Geneva, January 1995.

Note: Unrefined sugar, FOB, Caribbean ports, for export to the open market. Central American Bananas, CIF North Sea ports. Cocoa beans, average of daily prices (futures), New York/London. Coffee, mild arabica, *ex-dockNev/* ork. Beef, frozen and de-boned, all sosurces, United States ports. Fish meal, all sources, 64%-65% protein, CIF Hamburg. R laize, Argentina, CIF North Sea ports. Soybeans, United States, No. 2, yello, in bulk, CIF Rotterdam. Wheat, FOB Unil ïd States, No. 2, Hard Red Winter. Cotton, United States M 1-3/32", CIF Northern Europe. Wool, clean, combed, 48" ¡ quality, United Kingdom. Copper, tin, lead and zinc, spot prices on the London Metal Exchange. Iro ore, Brazil to I urope, C. 64.5% Fe, FOB. Oil, IMF average, average of spot prices for Dubai, Brent (United Kingdom) and Alaskan North Slope oil, which reflects a fairly balanced mix of medium, light and heavy crude worldwide.

[a] Preliminary figures. [b] US cents per pound. [c] Dollars per metric ton. Dollars per pound. 'Dollarsper carrel.

have been drastically larger had it not been for the sharp contraction of imports in Venezuela, which was experiencing a severe banking and foreign-exchange crisis. If Venezuela is excluded, the region's merchandise trade deficit shows a much larger increase -from US$ 13.2 billion in 1993 to US$ 22.7 billion in 1994. The 1994 trade gap resulted mainly from higher deficits in Argentina, Mexico and Peru, and from the notable decrease in Brazil's trade surplus. These setbacks were partially offset by better results in Chile, which turned its trade deficit into a surplus, and by the strong expansion in Venezuela's surplus, resulting from the decrease in its imports (see table IV-10).

The trade balance for services evolved somewhat more favourably than for goods, since the deficit in non-factor services fell 6%. This decrease is attributable chiefly to higher net incomes in Colombia and Uruguay, which climbed to US$ 400 million and US$ 150 million, respectively, and to the reduction in Venezuela's deficit (US$ -1 billion). However, it was partially counteracted by higher net outlays in Argentina, Brazil and Mexico. The increase in Colombia was due to higher earnings from various services, while in Uruguny, the main factor was travel and tourism. Both the decrease in Venezuela and the increases i:i Argentina, Brazil and Mexico reflected the peiormance of transport services, which are closdy linked to merchandise imports; in Venezuela, these services slumped, while in the other three countries they expanded notably (see table IV-10).

After decreasing in 1991 and 19Ç2, the deficit in Latin American and Caribbean profits and interest increased by US$ 31 billion, to US$ 33

Figure rV-1
LATIN AMERICA AND THE CARIBBEAN: REAL EXPORT PRICES '
(1994 percentage variations from 1975-1976 average)

Unrefined sugar
Tin
Cocoa
Maize
Wheat
Soya
Wool
Fish meal
Cotton
Zinc
Lead
Iron ore
Crude oil
Coffee (mild)
Beef
Copper
Bananas

-80 -60 -40 -20 20

Percentage decrease

Source: ECLAC, on the basis of figures from the United Nations Con erence on Trade and Development (UNCTAD).
a Nominal prices deflated by the unit values of exports of manufacturas by developed market economies.

billion in 1993 and US$ 34.2 billion in 1994. The main differences as compared with the previous year were increases in net outlays for factor payments of US$ 1.2 billion in Mexico, almost US$ 700 million in Argentina, US$ 270 million in Chile and around US$ 200 million in Colombia. Brazil, however, reduced its deficit by US$ 1.5 billion (see table IV-11).

The higher regional deficit due to factor service payments reflects the net effect of interest payments and steady profit remittances. The interest due on the external debt increased, in part, because of the rise in international interest rates in dollars. While this has not yet had a sizeable impact, it will be fully felt next year, since the rates have been rising steadily, and recently, at the end of the year, began to climb more rapidly. Added to this is :he discrepancy between the increase in interest rates and in the amount of interest due. Profits remittances on foreign direct investment also increased, as a result of falling real exchange rates and the greater weight of such investmer t in the region's economies.

The balance-of-payments deficit on the Latin American current account inci eased in 1994,

Table IV-8

LATIN AMERICA AND THE CARIBBEAN: TERMS OF TRADE IN GOODS EOB/CIF

(Indexes: 1980 = 100)

	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994[a]
Latin America and the Caribbean	**87**	**79**	**80**	**78**	**78**	**77**	**72**	**69**	**68**	**70**
South American countries	**89**	**83**	**82**	**84**	**83**	**80**	**77**	**72**	**71**	**74**
Argentina	80	73	63	66	68	64	60	60	62	61
Bolivia	86	75	77	69	71	68	64	52	48	52
Brazil	81	100	89	99	86	81	85	82	84	87
Chile	81	86	92	103	97	85	86	81	74	82
Colombia	88	119	112	104	99	90	92	81	78	89
Ecuador	114	79	86	76	82	79	68	66	56	55
Paraguay	113	110	115	126	145	143	131	126	133	139
Peru	87	72	76	85	75	81	73	71	65	73
Uruguay	87	100	104	111	111	97	92	91	92	97
Venezuela	107	55	67	54	68	80	64	61	58	59
Mexico	**86**	**64**	**72**	**62**	**66**	**68**	**61**	**60**	**61**	**62**
Central American and Caribbean countries	**91**	**105**	**94**	**92**	**89**	**89**	**88**	**87**	**86**	**88**
Costa Rica	102	125	102	101	96	96	86	84	85	89
El Salvador	76	107	70	75	64	56	56	53	55	64
Guatemala	78	101	87	88	89	90	88	83	84	88
Haiti	82	74	79	71	60	63	59	54	55	58
Honduras	86	101	94	105	102	101	105	102	111	117
Nicaragua	87	89	94	85	93	78	68	46	51	59
Panama	107	114	110	94	97	112	110	110	103	99
Dominican Republic	84	88	79	86	74	57	58	53	50	54

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

[a] Preliminary figures.

Table IV-9

LATIN AMERICA AND THE CARIBBEAN: PURCHASING POWER OF EXPORTS OF GOODS

(Indexes: 1980 = 100)

	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994'
Latin America and the Caribbean	**115**	**103**	**111**	**121**	**124**	**130**	**129**	**135**	**143**	**160**
South American countries	**110**	**101**	**105**	**122**	**123**	**128**	**128**	**135**	**143**	**161**
Argentina	115	91	76	100	99	127	112	112	121	142
Bolivia	72	66	63	62	76	79	75	60	69	92
Brazil	135	143	152	192	172	151	166	191	213	232
Chile	97	105	123	156	168	160	174	192	181	219
Colombia	94	149	151	136	145	162	183	175	180	202
Ecuador	166	122	109	126	133	145	140	147	132	140
Paraguay	151	187	189	269	369	436	339	318	494	501
Peru	90	68	68	67	75	64	64	67	66	84
Uruguay	90	130	131	151	161	158	148	157	161	183
Venezuela	86	51	60	54	70	94	79	73	74	83
Mexico	**155**	**118**	**146**	**136**	**147**	**159**	**152**	**154**	**161**	**179**
Central American and Caribbean countries	**82**	**90**	**87**	**85**	**86**	**93**	**97**	**104**	**111**	**118**
Costa Rica	105	131	130	133	144	146	161	187	210	224
El Salvador	55	60	45	43	32	37	37	37	46	50
Guatemala	69	74	66	70	75	83	79	82	86	92
Haiti	101	87	101	86	68	71	67	30	35	21
Honduras	89	106	100	110	113	113	113	112	121	121
Nicaragua	71	60	65	51	75	72	54	43	49	61
Panama	92	101	103	86	90	114	132	155	160	168
Dominican Republic	79	81	77	95	78	58	55	46	42	50

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

[a] Preliminary figures.

Table IV-10

LATIN **AMERICA** AND **THE** CARIBBEAN: TRADE BALANCE

(Millions of dollars)

	Exports of goods FOB			Imports of goods **FOB**			Merchandise trade balance			Net service payments[a]			Trade balance		
	1992	1993	1994	1992	1993	1994	1992	1993	1994	1992	1993	1994	1992	1993	1994
Latin America and the Caribbean	**145 982**	**156 012**	**181041**	**151 557**	**166 272**	**195 782**	-5 **575**	**-10 260**	**-14 741**	-8 **989**	**-10 151**	**-9 524**	**-14 564**	**-20 411**	**-24 265**
South American countries	**89 461**	**93 083**	**107 961**	**73 305**	**84 059**	**97 985**	**16** 156	9 **024**	9 **976**	-9 **029**	**-11 208**	**-10 198**	7 **127**	-2 **184**	**-222**
Argentina	12 235	13 117	15 740	13 685	15 545	19 880	-1450	-2 428	-4 140	-2 189	-2 481	-2 590	-3 639	-4 909	-6 730
Bolivia	608	710	985	1041	1 112	1 122	-433	-402	-137	-150	-103	-88	-583	-505	-225
Brazil	36 103	38 783	43 558	20 578	25 711	33 168	15 525	13 072	10 390	-3 224	-5 004	-5 557	12 301	8 068	4 833
Chile	9 986	9 202	11 539	9 236	10 181	10 879	750	-979	660	-64	3	19	686	-976	679
Colombia	7 263	7 429	8 573	6 030	9 086	10 901	1233	-1657	-2 328	-116	-21	375	1 117	-1 678	-1953
Ecuador	3 008	3 062	3 717	2 083	2 474	3 272	925	588	445	-313	-475	-387	612	113	58
Paraguay	1082	1653	1739	1951	2 672	2 858	-869	-1019	-1 119	347	457	385	-522	-562	-734
Peru	3 485	3 463	4 502	4 050	4 043	5 611	-565	-580	-1 109	-668	-656	-614	-1233	-1 236	-1723
Uruguay	1703	1645	1913	1937	2 118	2 585	-234	-473	-672	277	276	433	43	-197	-239
Venezuela	13 988	14 019	15 695	12 714	11 117	7 709	1274	2 902	7 986	-2 929	-3 204	-2 174	-1655	-302	5 812
Mexico	**46 196**	**51886**	**60 833**	**62 130**	**65 367**	**79 375**	**-15 934**	**-13 481**	**-18 542**	-2 **054**	-1 **426**	**-1920**	**-17 988**	**-14 907**	**-20 462**
Central American and Caribbean countries	**10 325**	**11043**	**12 247**	**16 122**	**16 846**	**18 422**	-5 **797**	-5 **803**	-6 **175**	2 **094**	2 **483**	**2 594**	-3 **703**	-3 **320**	-3 **581**
Costa Rica	1739	1945	2 162	2211	2 610	2 813	-472	-665	-651	144	244	260	-328	-421	-391
El Salvador	598	732	818	1 559	1767	2 091	-961	-1035	-1273	20	29	70	-941	-1 006	-1203
Guatemala	1284	1 356	1 525	2 328	2 381	2 545	-1 044	-1025	-1020	127	117	57	-917	-908	-963
Haiti	73	86	52	197	215	141	-124	-129	-89	-36	-61	-38	-160	-190	-127
Wnnrliiriie	» n	84fi	867	990	944	1 014	-157	-98	-147	17	29	41	-140	-69	-106
Nicaragua	223	267	344	771	659	718	-548	-392	-374	-62	-57	-54	-610	-449	-428
Panama	5 012	5 299	5 842	5 892	6 152	6 824	-880	-853	-982	930	920	960	50	67	-22
Dominican Republic	563	* 512	637	2 174	2 118	2 276	-1 611	-1606	-1639	954	1 262	1 298	-657	-344	-341

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

[a] Excluding net payments of profits and interest. Exports and imports of goods include the maquiladora industry.

although to a smaller extent than in the previous year. The deficit has widened drastically in 1991, to US$ 19 billion; this figure shot up to US$ 37 billion in 1992 and US$ 46 billion in 1993. In 1994, the deficit's steep rise slowed, so that it reached US$ 49 billion. This deterioration reflects both the trend in the trade balance and the increase in the profits and interest deficit. Argentina, Brazil and Mexico accounted for nearly all of the deterioration in the current-account balance; it was partially offset by Chile's lower deficit and Venezuela's change in a positive direction. Mexico had the most notable deficit increase -from US$ 23.5 billion in 1993 to US$ 29.2 billion in 1994. In Argentina and Brazil the deficit also expanded considerably, by US$ 2.7 billion and US$ ¡500 million, respectively. The change in Vetezuela's trade balance meant a shift from a deficit of US$ 2.2 billion to an abundant surplus of US$ 4.1 billion. Meanwhile, Chile significantly reduced its current-account deficit, from USJ: 2.4 billion in 1993 to US$ 1 billion in 1994. *Asa* group, the Central American and Caribbean countries showed 1994 current-account results similar to those of the previous year, with deficit reductions in Costa Rica, Haiti and Panama and increases in the Dominican Republic and Guatemala.

5. **Capital flows and international reserves**

For the fourth year in a row, the region received a significant inflow of capital, totalling US$ 43 billion, although that represented a US$ 23 billion decrease as compared with 1993 (see table IV-11). This sharp setback was due mainly to a fairly steep drop in bond issues, which was very evident during the second quarter of 1994, and to a notable decrease in stock investments in Mexico. It should be noted that there was also a sharp decrease in bond issues world-wide during the second quarter of 1994, caused mainly by the rise in United States interest rates. Other types of capital flows, including direct investment, Eurocommercial paper and supplier credits, increased during 1994.

Despite the turbulence in the international financial markets, especially in the second quarter of 1994, as well as the political and economic problems that prevailed in some countries during the year, capital flows to most of the region's countries remained at essentially the same levels. A further factor was that in 1994 investors had discriminated among the region's countries on the basis of their economic and political trends, so that the drops in capital inflows were limited to specific countries, rather than being widespread. Thus, during 1994 such reductions were mainly concentrated in two countries, Mexico and Venezuela.

Mexico registered a net inflow of more than US$ 10 billion in 1994, which, however, was only a third of the previous year's figure, and far below the amount required to finance the huge current-account deficit. This drastic reduction was triggered mainly by domestic political instability, the rise in United States interest rates and uncertainty in the financial markets. All of this was reflected in a sharp reduction in portfolio investment and other long-term capital investment, since direct investmen) grew rapidly. Net flows on the stock marke: climbed to US$ 7.6 billion, a figure that coitrasts greatly with the US$ 28 billion worth of inflows in the previous year.

Direct investment, on the other hand, increased remarkably (63%), from almost US$ 5 billion in 1993 to US$ 8 billion in 1994. As a result of the reduced flows, Mexico attracted only 23% of the external resources earmarked for the region in 1994, or well below the 50% it achieved during the previous four-year period.

Venezuela saw a net outflow of capital estimated at nearly US$ 5 billion, chiefly because of its economic instability, which, in turn, was rooted in the serious difficulties afflicting its banking system and the subsequent economic policy changes. The only funds which the country received were in the form of direct investment totalling US$ 140 millic n. It is worth mentioning that the institution of foreign-exchange controls in the th: rd quarter of 1994 reversed the trend towards ca jital-account deficits through the mandatory deferral of principal and interest payments, while rules were

Table IV-11

LATIN AMERICA AND THE CARIBBEAN: BALANCE OF PAYMENTS

(Millions of dollars)

	Private transfers			Net payments of profits and interest[3]			Balance on current account			Balance on capital account[0]			Total balance		
	1992	1993	1994	1992	1993	1994	1992	1993	1994	1992	1993	1994	1992	1993	1994
Latin America and the Caribbean	**8 801**	**7 488**	**9 535**	**-31141**	**-33 009**	**-34 209**	**-36 906**	**-45 930**	**-48 937**	**61606**	**66 752**	**43 514**	**24 700**	**20 822**	**-5 423**
South American countries	**4 296**	**3 132**	**3 834**	**-19 492**	**-20 183**	**-20 187**	**-8 070**	**-19 234**	**-16 575**	**30 654**	**32 660**	**30 444**	**22 584**	**13 425**	**13 869**
Argentina	749	535	310	-3 656	-2 989	-3 650	-6 546	-7 363	-10 070	11095	9 911	10 694	4 549	2 548	624
Bolivia	23	21	24	-193	-205	-188	-754	-689	-388	780	826	520	26	137	132
Brazil	2 047	1 682	2 596	-8 082	-10 358	-8 880	6 266	-608	-1 451	8 802	9 821	7 965	15 068	9 213	6 514
Chile	74	61	54	-1 860	-1 503	-1 772	-1 100	-2 418	-1 039	3 646	2 838	4 233	2 546	420	3 194
Colombia	1 747	1 138	843	-1939	-1541	-1 722	925	-2 081	-2 833	167	2 062	2 998	1 092	-19	165
Ecuador	-	-	-	-805	-773	-1000	-193	-660	-942	215	1 132	1400	22	472	458
Paraguay	3	5	-	-115	-88	-81	-634	-644	-815	287	731	1 142	-347	86	327
Peru	-	-	-	-910	-981	-1011	-2 143	-2 217	-2 734	2711	2 662	5 852	568	445	3 118
Uruguay	-	-	-	-187	-141	-196	-144	-338	-435	234	445	556	90	107	121
Venezuela	-347	-310	7	-1 745	-1 604	-1 687	-3 747	-2 216	4 132	2 717	2 232	-4 916	-1 030	16	-784
Mexico	**2 908**	**2 591**	**3 712**	**-9 839**	**-11 171**	**-12 416**	**-24 919**	**-23 487**	**-29 165**	**26 664**	**30 719**	**10 282**	**1745**	**7 232**	**-18 883**
Central American and Caribbean countries	**1597**	**1765**	**1989**	**-1810**	**-1655**	**-1606**	**-3 917**	**-3 209**	**-3 197**	**4 288**	**3 373**	**2 788**	**371**	**165**	**-409**
Costa Rica	88	86	80	-216	-201	-204	-455	-537	-515	631	478	295	176	-59	-220
El Salvador	709	823	1001	-104	-117	-100	-337	-299	-302	429	411	445	92	112	143
Guatemala	339	362	384	-179	-143	-145	-758	-689	-724	738	833	722	-20	144	-2
Haiti	70	73	43	-9	-9	**-9**	-99	-126	-93	68	99	56	-31	-27	-37
Honduras	61	61	56	-335	-321	-269	-413	-328	-319	424	222	352	11	-106	33
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Panama	-27	-27	-25	-253	-177	-53	-230	-136	[illegible]	346	226	170	116	90	70
Dominican Republic	347	362	420	-219	-258	-360	-530	-241	-281	557	330	-184	27	90	-465

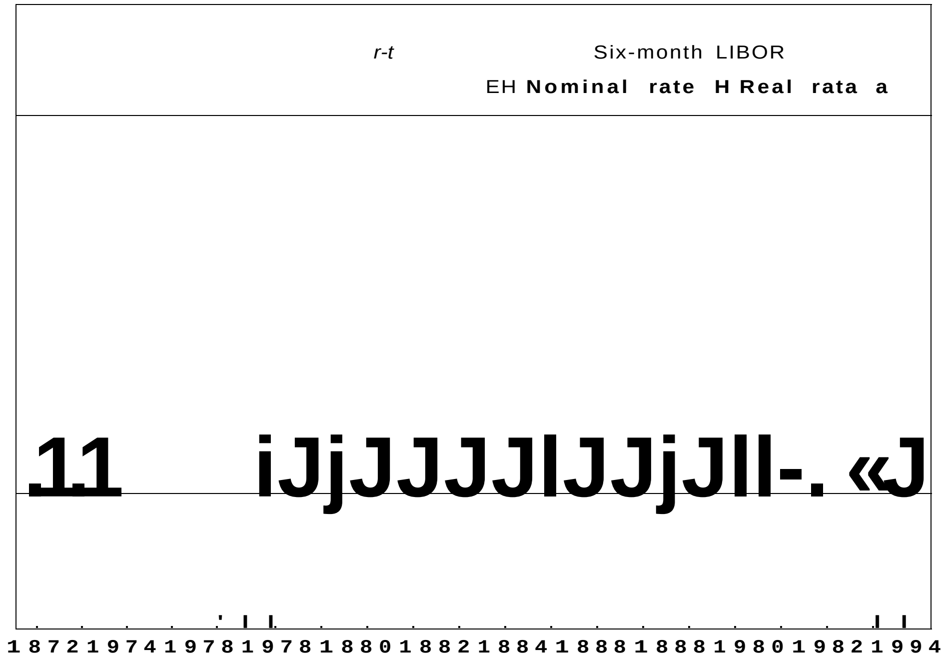
Source: ECLAC, on the basis of figures from the International Monetary Fund (IMF) and national sources.

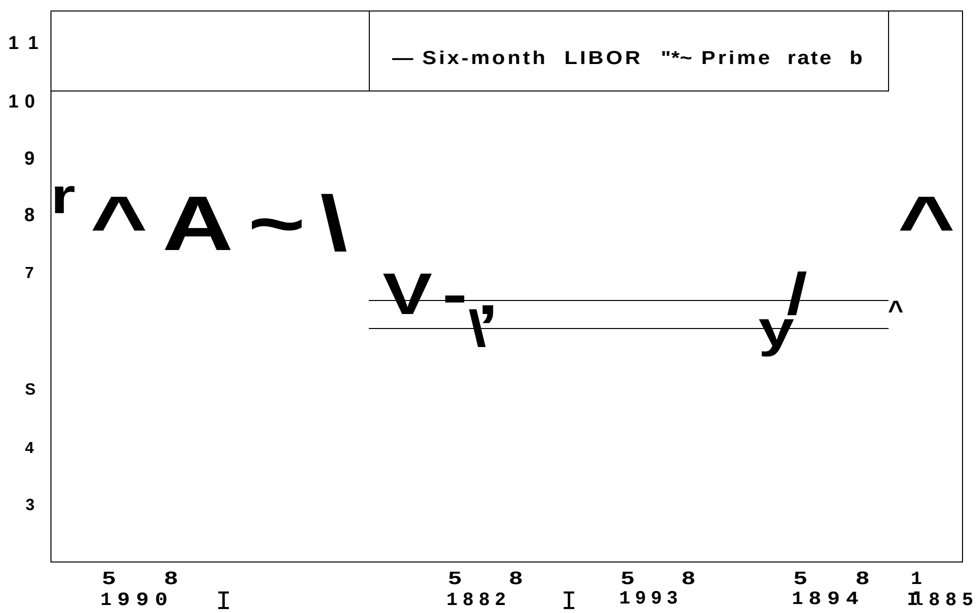
Excluding labour and ownership. ' Including net unrequited private transfers. Including long- and short-term capital, unrequited official transfers, and errors and omissions. Equal to variation in international reserves (of opposite sign), plus counterpart items.

Figure IV-2

LATIN AMERICA AND THE CARIBBEAN: INTERNATIONAL INTEREST RATES

(Percentages)





Source: ECLAC, on the basis of figures from IMF.
a Nominal rate deflated by the consumer price Index for Industrialized countries.
b The prime rate is the preferential rate offered by United States banks to their **best cuslomers.**

established for the allocation of foreign exchange.

In contrast, several countries saw an increase in capital inflows during 1994. This was particularly notable in Peru, where net capital inflows nearly reached the record figure of US$ 6 billion, equivalent to 11% of GDP. Some 40% of these resources were in the form of direct investment, and of these, two thirds came from the privatization of the Peruvian National Telecommunications and Telephone Company. In Chile, net capital inflows were up sharply, from US$ 2.85 billion in 1993 to US$ 4.25 billion in 1994, despite the existence of rules to discourage short-term capital inflows. Some 25% of this amount consisted of portfolio investment and 21% of direct investment, which was heavily concentrated in the mining industry, while the remainder consisted mainly of short-term capital.

Colombia also saw an abundant and unprecedented net inflow of capital, amounting to US$ 3 billion, of which 40% was in the form of direct investment, despite the introduction of measures to discourage short-term flows. As in the previous year, Argentina managed to attract external resources worth US$ 10.5 billion. Paraguay and Uruguay also received more external resources in 1994 than in the preceding year. Uruguay increased its resources by more than US$ 100 million, and Paraguay registered a sharp increase, although a high proportion of these funds were from unidentified sources (i.e., were registered under "errors and omissions").

Brazil had smaller net capital inflows in 1994 than in 1993, reaching only US$ 8 billion. Nevertheless, long-term net flows rose to almost US$ 13 billion, including around US$ 2 billion in direct investment and US$ 6 billion in portfolio investment. Short-term net capital outlays, however, amounted to more than US$ 4 billion, especially because of the payment of cumulative arrears incurred in previous years.

The Central American and Caribbean countries as a group saw a slight decrease (US$ 100 million) in external resource flows in 1994 due to competing trends. Thus, the Dominican Republic witnessed a turnaround in its 1993 capital flows, which became a net outflow of US$ 180 million in 1994, while in Costa Rica, the net capital received in the previous year decreased by nearly US$ 200 million, and in Guatemala, Haiti and Panama, such flows decreased to a lesser extent. El Salvador, Honduras and Nicaragua were the only countries in this group whose n ît capital flows increased.

During 1994 total Latin American bond issues amounted to nearly US$ 20 billicn, which meant a contraction of 30% as compared with the 1993 sales of US$ 29.5 billion (see tibies IV-14 and IV-15 and figure IV-3). Thi¡ amount was substantially lower than the 1993 sales figure, but much higher than the one for 19 ?2. It should be noted that the drop in bond issues was concentrated in the second quar er of 1994, but that bonds began to recover in the third quarter, gaining momentum in the last on:. This suggests that towards the end of 1994 the bond market was gradually recovering from the d image inflicted on it by the initial rise in United States interest rates. However, following the devaluation of the Mexican peso on 20 December, bond sales contracted wildly and rose to barely US$ 1 billion during the first four manths of 1995. Thirteen Latin American countiies participated in the bond market in 1994. Bond sales were heavily concentrated in three co íntries: Mexico (40%), Argentina (27%) and Bnzil (20%). The rest were sold in Chile, Colombia, Jamaica, Panama, Peru, Trinidad and Tobago and Uruguay, as well as in Barbados, Bolivia and Costa Rica, countries which had ecently entered this market.

Shorter maturity periods wen; seen for Latin American bonds in 1994, especially during the second quarter, when the av;rage regional period fell to slightly more than 3 years. This trend was reversed during thî second half, when average maturity periods rose to 4 years, i.e., levels approaching the average for 1991-1993. A higher proportion of bonds were issued with variable interest ratos, owing to the trend towards increases in such rates and to volatility in the markets. An increase was also seen in premiums over the referei ice interest rates on bonds, which meant higher costs for borrowers. Lastly, the proportion of

Table IV-12

LATIN AMERICA AND THE CARIBBEAN: RATIO OF THE BALANCE-OF-PAYMENTS DEFICIT ON CURRENT ACCOUNT TO THE VALUE OF EXPORTS OF GOODS AND SERVICES [a]

(Percentages)

	1986	1987	1988	1989	1990	1991	1992	1993	1994 [b]
Latin America and the Caribbean	**18.0**	**9.8**	**9.1**	6.5	**2.7**	**12.4**	**22.8**	**56.7**	**24.9**
South American countries	**22.3**	**16.9**	**7.9**	**0.0**	-7.0	**1.4**	**7.6**	:i7.4	**12.9**
Argentina	33.9	52.0	14.0	11.1	-30.8	4.5	44.3	46.7	54.2
Bolivia	69.9	80.9	63.7	46.1	34.5	46.0	97.5	"7.2	32.8
Brazil	21.9	5.0	-11.6	-2.7	11.0	4.2	-15.7	1.4	3.0
Chile	23.7	13.8	3.4	9.0	7.8	2.6	8.9	:;o.4	7.2
Colombia	-6.2	-5.0	3.0	2.6	-6.4	-26.0	-10.0	::i.o	23.9
Ecuador	24.4	53.3	26.8	24.1	9.7	19.1	5.3	:7.8	21.1
Paraguay	49.4	66.9	22.1	14.8	11.7	20.8	35.0	'/5.5	29.8
Peru	39.3	50.7	39.5	3.2	27.3	39.2	49.5	'.0.9	48.5
Uruguay	-1.1	10.1	1.1	-5.6	-7.5	-0.1	5.7	13.2	13.8
Venezuela	23.4	12.0	52.3	-15.5	-44.1	-10.8	24.2	14.2	-23.7
Mexico	**6.8**	**-14.5**	**8.8**	**18.1**	**22.8**	**37.8**	**60.1**	**Í2.4**	**58.2**
Central Americani and Caribbean countries	**15.3**	**25.8**	**19.0**	**24.2**	**18.6**	**17.6**	**25.4**	**19.2**	**17.3**
Costa Rica	13.9	30.6	24.3	30.8	28.4	7.6	17.6	17.9	15.5
El Salvador	11.4	24.5	28.9	62.7	43.3	40.9	34.6	26.3	22.7
Guatemala	3.6	47.1	39.1	30.8	15.0	11.0	39.9	34.1	31.4
Haiti	49.6	45.6	61.8	75.0	62.4	70.6	78.6	105.0	124.0
Honduras	25.9	34.7	31.0	31.0	27.3	31.2	39.7	30.8	28.7
Nicaragua	279.4	250.8	309.6	155.7	129.2	251.0	353.9	232.3	194.0
Panama	-6.3	-5.3	-13.8	-1.3	1.6	5.1	3.6	2.0	1.4
Dominican Republic	17.3	27.0	4.4	14.4	8.1	4.7	25.3	1).3	11.1

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

[a] Negative figures indicate a surplus on the balance-of-payments current account. Preliminary figures.

private-sector bond issues fell during the first six months, but this trend was reversed during the remainder of the year.

Since 1991, portfolio stock investments, on both local and foreign stock exchanges (mainly in the United States) have constituted a new source of foreign finance capital. The profits from such investments, expressed in dollars, which had been very sizeable in 1993, fell sharply, and some countries registered major losses. Stock prices at the end of 1994, as compared with those at the end of 1993, fell in Mexico (-41%), Venezuela >27%) and Argentina (-25%), while rising in 3razil (68%), Peru (52%) and Chile (41%). Towa rds the end of 1994, the average weighted price per share in Latin America decreased by 2e/o (see table IV-16).

A large number of Latin Ameria in enterprises continued to trade in American Depository Receipts (ADRS), and, to a lesser ertent, Global Depository Receipts (GDRs). In 1994 international sales of Latin Amer can primary stocks (fresh capital) verged on US$ 4.7 billion,

Table IV-13

INTEREST RATES IN INDUSTRIALIZED-MARKETS

(Year-end)

	1980	1985	1988	1989	1990	1991	1992	[993	1994
				Discount rates					
Germany	7.5	4.0	**3.5**	6.0	6.0	8.0	8.3	5.8	4.5
Canada	17.3	9.5	11.2	12.5	11.8	7.7	7.4	4.1	7.0
United States	13.0	7.5	**6.5**	7.0	6.5	3.5	3.0	3.0	4.8
France	9.5	9.5	**9.5**	9.5	9.5	9.5	9.5	9.5	9.5
Italy	16.5	5.0	12.5	13.5	12.5	12.0	12.0	8.0	7.5
Japan	7.3	5.0	**2.5**	4.3	6.0	4.5	3.3	1.8	1.8
Netherlands	8.0	0.7	**4.5**	7.0	7.3	8.5	7.8	5.0	
				Short-term financial market rates					
Germany	9.1	5.2	**4.0**	6.6	7.9	8.8	9.4	7.5	5.3
Canada	19.0	9.6	**10.4**	12.1	11.6	7.4	6.8	3.8	5.5
United States	13.4	8.1	**7.6**	9.2	8.1	5.7	3.5	3.0	4.2
France	11.9	9.9	**7.5**	9.1	9.9	9.5	10.4	8.8	5.7
Italy	17.2	15.3	11.3	12.7	12.4	12.2	14.0	10.2	
Japan	10.9	6.5	**3.6**	4.9	7.2	7.5	4.6	3.1	2.2
Netherlands	10.1	6.3	**4.5**	7.0	8.3	9.0	9.3	7.1	5.1
United Kingdom	15.6	10.8	10.3	13.9	14.7	11.8	9.6	5.5	4.8
				Long-term financial market rates					
Germany	8.5	6.9	6.1	7.1	8.9	8.6	8.0	6.3	4.5
Canada	12.5	11.0	10.2	9.9	10.9	9.8	8.8	7.9	8.6
United States	11.5	10.6	8.9	8.5	8.6	7.9	7.0	5.8	7.1
France	13.0	10.9	9.1	8.8	10.0	9.1	8.6	6.9	7.4
Italy	16.1	13.0	10.2	10.7	11.5	13.2	13.3	11.3	10.6
Japan	9.2	6.3	4.3	5.1	7.4	6.5	4.9	3.7	3.7
Netherlands	10.2	7.3	6.3	7.2	8.9	8.7	8.1	6.5	7.2
United Kingdom	13.8	10.6	9.4	9.6	11.1	9.9	9.2	7.9	8.1

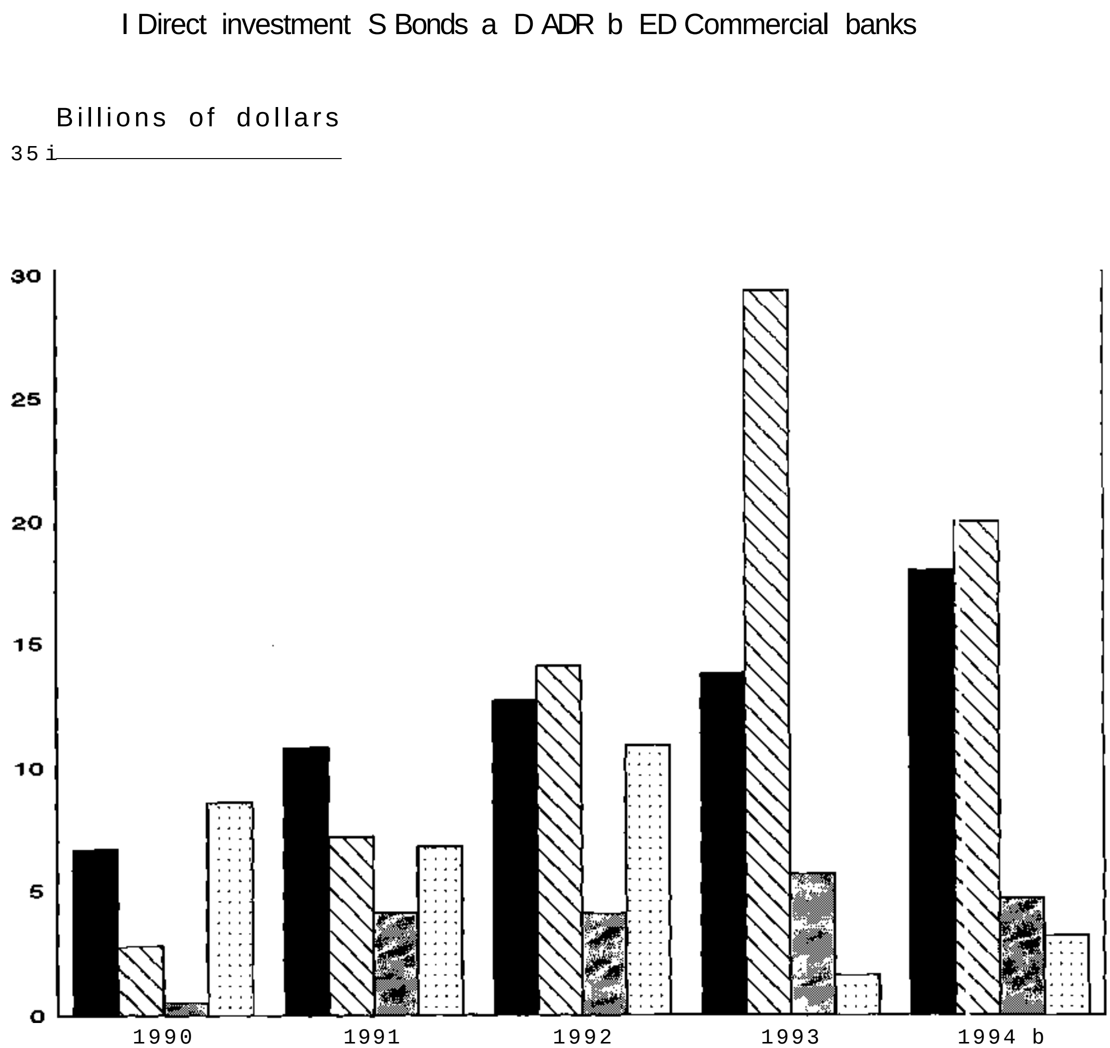
Source: International Monetary Fund (IMF), *International Financial Statistics,* Washington, D.C. (various issi íes).

which meant a drop of 17% as compared with 1993. Of this amount, 35% went to Mexico, and the remainder to Argentine, Brazilian, Chilean, Colombian and Peruvian companies. It is worth noting that US$ 1.03 billion flowed to Brazil, US$ 735 million to Argentina and US$ 600 million to Chile. Meanwhile, Peru, which attracted US$ 130 million in 1994, is eliciting growing interest among investors (see table IV-17).

Institutional investors have begun to pay greater attention to company reputations and liquidity positions. Towards the end of 1994, a number of Latin American enterprises which issued ADRS saw significant discounts in the price of their stocks, a trend that was heightened during the early months of 1995.

At the end of 1994, net loans f o the region by international commercial banks showed a slight surplus, reaching US$ 3.2 billioi, according to data provided by the Bank for International Settlements. This amount results from two competing trends. On the one hand, Brazil's commercial debt, which had reached US$ 62.2 billion at the end of 1993, dropped by US$ 5.9 billion at the end of 1994, owing to the finalization of the Brady Plan debt reduction scheme; furthermore, in th< light of the

Figure IV-3
LATIN AMERICA AND THE CARIBBEAN: SOURCES OF EXTERNAL FINANCING
(Percentages)



Source: ECLAC, on the basis of figures from the International Monetary Fund, the International Settlements and the World Bank.
a Gross values. b Primary issues.

difficulties affecting Venezuela's domestic banking system, net bank loans to that country fell by US$ 3.9 billion during 1994. On the other hand, the level of net loans to Mexico (US$ 5.4 billion), Argentina (US$ 3.15 billion), Chile (US$ 2.25 billion), Colombia (US$ 650 million) and Peru (US$ 300 million) increased during 1994. It should be noted that these amounts include the increased borrowing R suiting from the adjustment of debts incurred in currencies other than United States dollars so as to compensate for the dollar's depreciation relative to the yen and European currencies. 1 furthermore, since the third quarter of 1994, the Latin American countries have had easier access to syndicated loans.

Table IV-14

LATIN AMERICA AND THE CARIBBEAN: SOME SOURCES OF EXTERNAL FINANCING

(Millions of dollars)

	1989	1990	1991	1992	1993	1994[a]
A. Debt						
Bonds [b]	833	2 760	7 242	14 018	29 *404*	19 866
Banks[0]	-6 497	8 559	6 800	10 943	163(	3 200
Commercial paper	127	-	1 212	840	31!	400
Certificates of deposit	-	-	670	1 100	6!	
B. Investment						
Direct[d]	6 134	6 728	10 830	12 727	13 8œ;	18 057
ADR/GDR [e]	-	98	4 120	4 063	5 726	4 689
External funds	416	575	727	293	1(1	565 [Ê]

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

[a] Preliminary estimates. Gross value. [c] Net, short- and medium-term. Includes reinvestment o: profits.
[e] ADR = American Depository Receipts; GDR = Global Depository Receipts. [f] Close-ended funds; initial capital. [g] First six months.

Table IV-15

LATIN AMERICA AND THE CARIBBEAN: INTERNATIONAL BOND ISS UES[a]

(Millions of dollars)

	1990	1991	1992	1993	1994
Total	**2 760**	**7 242**	**14 018**	**29 404**	**19 866**
Argentina	21	795	1630	6 428	5 319
Barbados		-	-	-	70
Bolivia		-	-	-	10
Brazil		1837	4 520	6 810	4 035
Chile		200	120	322	155
Colombia		-	-	567	955
Costa Rica		-	-	-	50
Guatemala		-	-	60	-
Jamaica		-	-	-	55
Mexico	2 477	3 782	6 480	11483	7 519
Panama		50	-	-	1248
Peru		-	-	30	100
Trinidad and Tobago		-	100	125	150
Uruguay		-	100	140	200
Venezuela	262	578	1068	3 439	-

Source: 1990-1991: International Monetary Fund (IMF), *Private market financing for developing countrie* i, Washington, D.C, December 1993; 1992-1994: IMF, estimates based on various sources.

[a] Gross financing.

Table IV-16

LATIN AMERICA AND THE CARIBBEAN: DOLLAR VALUES ON THE STOCK EXCHANGES

	Annual percentage change: from the preceding year, as at 30 December							
	1990[a]	1991[a]	1992[a]	1993[a]	1994			
					30-June	30-Sept.	16-Dec.	30-Dec.
Latin America					-6	25	15	-2
Argentina	-37	394	-28	67	-15	-2	-14	-25
Brazil	-67	149	-2	91	6	92	84	68
Chile	31	90	12	30	17	37	44	41
Colombia	26	174	36	32	51	39	19	27
Mexico	25	102	20	47	-19	-4	-18	-42 [b]
Peru				35	16	51	53	52
Venezuela	584	44	-43	-11	-34	-19	-30	-27

Source : ECLAC, on the basis of figures from the International Finance Corporation and *Latin America Weekly Report*, several issues.
Year-end. Mexico devalued the peso on 20 December 1994.

Table IV-17

LATIN AMERICA AND THE CARIBBEAN: INTERNATIONAL STOCK ISSUES [a]

(Millions of dollars)

	1990	1991	1992	1993	1994
Total	**98**	**4120**	**4 063**	**5** 726	**4 689**
Argentina		356	372	2 793	735
Bolivia				10	-
Brazil			133	-	1028
Chile	98		129	271	597
Colombia				91	393
Mexico		**3** 764	**3** 058	2 493	1680
Panama			**88**	-	100
Peru				26	133
Uruguay				-	23
Venezuela			283	42	-

Source: International Monetary Fund (IMF), *Private market financing for developing countries,* Washington, D.C., December 1993 (data to 1992) and figures provided directly (1993 and 1994).

[a] Corresponds to American Depository Receipts (ADRS) and Global Depository Receipts (GDRs) for widening of new :apital (primary issues).

6. External resource transfers

The net transfer of financial resources to Latin America and the Caribbean was positive for the fourth year in a row, but was notably smaller, representing less than a third of the 1993 amounts (see table IV-18). This transfer reached only US$ 9.1 billion in 1994, as compared with US$ 33.5 billion one year earlier. Tl lis result was due in large part to competing trends in five of the region's countries. Thus, the sharp decrease in transfers to Mexico and Venezuela was offset by increases in transfers to Peru, Chile and Colombia. The most spectacular turnaround

Table IV-18

LATIN AMERICA AND THE CARIBBEAN: NET CAPITAL INFLOW AND RESOURCE TRANSFERS [a]

(Billions of dollars and percentages)

	Effective net inflow of capital	Unregistered trans actions[0]	Net inflow of capital (1+2)	2/1	Net payments of profits and interest	Resource transfers		Export of goods and services	6/8	7/8
						(1-5)	(3-5)			
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
1980	33.6	-2.3	31.3	-6.8	18.8	14.8	12.5	101.6	14.6	12.3
1981	51.8	-11.7	40.1	-22.6	28.9	22.9	11.2	109.6	20.9	10.2
1982	32.7	-13.1	19.6	-40.1	38.8	-6.1	-19.2	99.6	-6.1	-19.3
1983	6.8	-4.1	2.7	-60.3	34.8	-28.0	-32.1	99.5	-28.1	-32.2
1984	13.6	-3.1	10.5	-22.8	37.5	-23.9	-27.0	110.8	-21.6	-24.4
1985	8.5	-4.9	3.6	-57.0	35.7	-27.2	-32.1	105.6	-25.8	-30.4
1986	11.0	-1.3	9.7	-11.8	32.4	-21.4	-22.7	91.3	-23.4	-24.9
1987	13.6	1.6	15.2	11.8	31.1	-17.5	-15.9	104.1	-16.8	-15.3
1988	7.9	-2'.0	5.9	-25.3	34.3	-26.4	-28.4	119.4	-22.1	-23.8
1989	7.6	4.5	12.1	60.0	38.3	-30.7	-26.2	132.7	-23.1	-19.7
1990	17.8	0.1	17.9	0.6	33.8	-16.0	-15.9	146.0	-11.0	-10.9
1991	37.0	0.4	37.4	1.1	31.0	6.0	6.4	146.0	4.1	4.4
1992	59.8	1.5	61.3	2.5	30.9	28.9	30.4	154.5	18.7	19.7
1993	66.5	0.2	66.7	0.3	33.0	33.5	33.7	164.9	20.3	20.4
1994 [d]	43.3				34.2	9.1		189.2	4.8	

Source: 1980-1991: ECLAC on the basis of figures from the International Monetary Fund (IMF);
1992-1994: ECLAC on the basis of figures from IMF and national sources.

[a] Covers 16 Spanish-speaking countries (Cuba and Panama are not included), plus Brazil and Haiti. ' Equal to net inflow of capital minus unregistered transactions. [c] Corresponds to the errors and omissions entry on the I lalance of payments. Preliminary estimates.

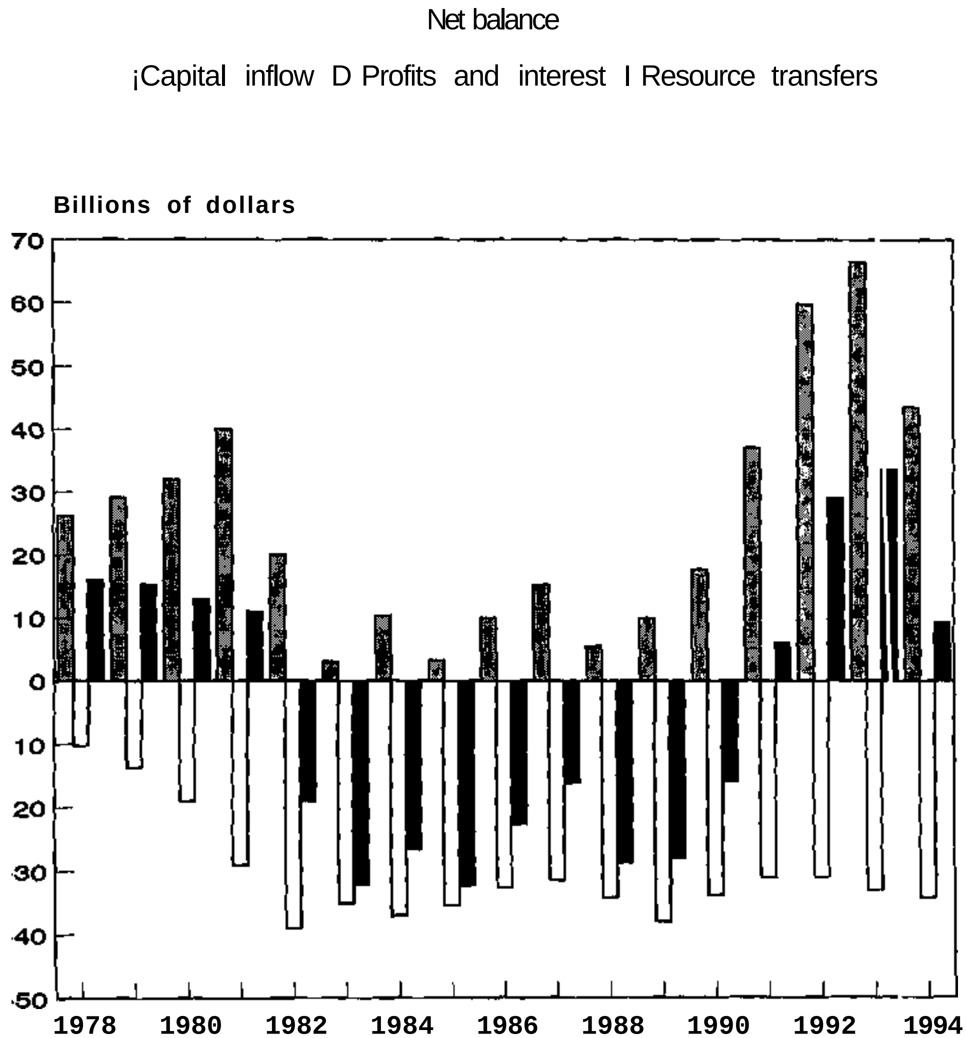
occurred in Mexico, where an inflow of nearly US$ 20 billion in 1993 became an outflow of US$ 2.1 billion in 1994. Other salient examples were Venezuela's and the Dominican Republic's exceedingly negative net transfers (US$ 6.6 billion and US$ 540 million respectively). Another five countries decreased net resource transfers, including Bolivia, Brazil, Costa Rica, Haiti and Guatemala. Argentina, however, maintained a broad surplus (US$ 7 billion); Peru nearly tripled its 1993 transfer (US$ 4.8 billion), Chile almost doubled its figure (US$ 2.5 billion), and Colombia achieved the highest positive transfer of the most r;cent five-year period (US$ 1.3 billion). Hcnduras's 1993 negative net transfer became a positive one in 1994 (US$ 80 million), but this was wholly attributable to overdue debt-seivice payments, which were counted as capital income. Other countries which increased their net resource transfers were Ecuador, Paraguay and Uruguay.

7. The external debt

a) Main trends

The Latin American and Caribbean region's external debt rose by nearly US$ 26 billion in 1994, totalling US$ 533 billion by the end of the year (see table IV-20). This represents an increase of 5.3%, a slightly higher growth rate than in the preceding three-year period (4.6%). The expansion of the debt was due chiefly to bond sales totalling US$ 20 billion. These sales played an important role n the largest economies; in 1994 the bo ids issued by

Figure IV-4
LATIN AMERICA AND THE CARIBBEAN: NET CAPITAL INFLOW AND RESOURCE TRANSFERS



Source: ECLAC, on the basis of official figures from the International Monetary Fund.

Argentina, Brazil and Mexico represented more than 85% of all bonds sold by the Latin American countries. Other factors contributing to the growth of the debt were Eurocommercial paper and medium-term commercial paper, syndicated loans, supplier credits and variations in exchange rates due to the depreciation of the dollar, especially relative to the deutsche mark and the yen. In other countries, especially those with smaller economies, loans from multilateral institutions and bilateral sources contributed to increased borrowing. On the othei side of the coin, Brazil, the Dominican R(public and Ecuador curbed or reduced their deb ; through the formalization of debt reduction schîmes within the Brady Plan framework.

Most Latin American countries saw minor changes in the amount of their external debt.

Table IV-19

LATIN AMERICA AND THE CARIBBEAN: NET RESOURCE TRANSFERS [a]

	Net resource transfers (millions of dollars)								Ratio of net resource ñ transfers to exports of goods and services (%)				
	1989	1990	1991	1992	1993	1994[b]	1982-1990	1991-1994[b]	1990	1991	1992	1993	1994[b]
Latin America and the Caribbean	**-26 231**	**-15 922**	6 **448**	**30 372**	**33 695**	9 **189**	**-219 470**	79 **704**	**-10.9**	**4.4**	**19.5**	**20.4**	**4.9**
South American countries	**-25 516**	**-18 963**	-9 **806**	**11162**	**12** 477	**10 257**	**-158 386**	**24 090**	**-19.1**	**-10.0**	**10.6**	**11.3**	**8.0**
Argentina	-6 465	-5 573	-984	7 439	6 922	7 044	-33 182	20 421	-37.7	-6.8	50.3	43.9	37.9
Bolivia	40	111	202	587	621	332	325	1742	11.3	22.0	76.0	69.6	28.1
Brazil	-11 854	-6 559	-8 012	720	-537	-915	-74 749	-8 744	-18.9	-23.3	1.8	-1.3	-1.9
Chile	-495	1314	-272	1786	1335	2 461	-4 072	5 310	12.9	-2.5	14.4	11.3	17.1
Colombia	-1670	-2 216	-2 527	-1772	521	1276	-6 840	-2 502	-25.6	-27.9	-19.2	5.3	10.8
Ecuador	2	-336	-141	-590	359	400	-3 057	28	-10.3	-4.1	-16.2	9.7	9.0
Paraguay	-112	392	640	172	643	1061	1711	2 516	20.9	33.9	9.5	25.4	38.8
Peru	-189	361	1504	1801	1681	4 841	301	9 827	8.9	35.7	41.6	38.6	85.8
Uruguay	-360	-331	-80	47	304	360	-2 203	631	-15.3	-3.6	1.9	11.8	11.4
Venezuela	-4 413	-6 126	-136	972	628	-6 603	-36 620	-5 139	-32.6	-0.8	6.3	4.0	-37.8
Mexico	**-2 527**	2 **128**	**14107**	**16 825**	**19 548**	**-2 133**	-71 **829**	**48 347**	**5.5**	**35.5**	**40.6**	**43.6**	-4.3
Central American and Caribbean countries	**1812**	**913**	**2 147**	2 **385**	**1670**	**1065**	**10 745**	7 **267**	**11.3**	**25.6**	**26.4**	**16.6**	**9.6**
Costa Rica	333	119	328	414	277	91	967	1 110	6.0	14.9	16.0	9.3	2.7
El Salvador	519	411	172	325	295	345	1755	1 137	46.7	19.1	33.3	25.9	26.0
Guatemala	318	-	600	559	690	577	1534	2 426	-	35.6	29.5	34.2	25.0
u»:»'	*15[A].*	154	**107**	**SO**	00	47	1 341	323	63.0	50.9	46.8	75.0	62.7
Honduras	"49	57	106	90	-99	83	837	180	5.5	10.4	8.7	-9.3	7.5
Nicaragua	390	251	572	600	344	466	4 235	1982	63.9	169.0	194.1	93.8	104.7
Dominican Republic	49	-79	242	338	73	-544	76	109	-3.9	12.2	16.1	3.1	-21.4

Source: 1989-1991: ECLAC on the basis of figures from the IMF;
1992-1994: ECLAC on the basis of figures from the IMF and national sources.

[a] The net transfer of resources is equal to the net capital inflow (unrequited <)fficial transfer payments, short- and long-term capital, and errors and omissions), minus net payments of profits and interest, which include both interest actually paid and interest due but not paid. In this table, negative figures indicate outward transfers of resources. [D]]Preliminary figures.

Table IV-20

LATIN AMERICA AND THE CARIBBEAN: TOTAL DISB131SED EXTERNAL DEBT ′

(MUMons of dollars and growth rates)

	Year-end balances								Annual growth rates				
	1987	**1988**	**1989**	**1990**	**1991**	**1992**	1993	1994[b]	1979-1981	**1982-1983**	**1984-1990**	**1991-** 1993	1994[b]
Latin America and the Caribbean	**427 665**	**419 728**	**424 904**	**442 720**	**457 501**	**474 806**	**506 680**	**533 290**	**22.9**	**11.2**	**3.2**	**4.6**	**5.3**
South American countries	**292 152**	**284 773**	**292 491**	**302 456**	**305 315**	**323 155**	**341363**	**359 286**	**20.9**	**10.5**	**3.5**	**4.1**	**5.3**
Argentina	58 324	58 473	63 314	60 973	63 700	65 000	68 000	75 000	41.9	12.4	4.4	3.7	10.3
Bolivia[c]	4 278	4 043	3 492	3 768	3 582	3 784	3 777	4 208	14.3	9.4	2.5	0.1	11.4
Brazil	121 174	113 469	115 096	123 439	123 811	135 949	145 660	149 506	14.4	10.6	3.3	5.7	2.6
Chile	20 660	18 960	17 520	18 576	17319	18 964	19 665	21 888	30.5	7.6	0.4	1.9	11.3
Colombia	17 523	17 960	17 604	17 848	17 312	16 862	18 370	21280	28.0	16.0	6.5	1.0	15.8
/Ecuador	10 320	10 581	11322	11856	12 271	12 122	12 806	13 664	21.0	18.3	7.0	2.6	6.7
Guyana	1 736	1 778	1801	1812	1 856	1 871	1906	1950	28.1	17.8	9.5	1.7	2.3
Paraguay	2 043	2 002	2 027	1695	1666	1279	1254	1272	12.3	24.5	2.1	-9.6	1.4
Peru	15 373	16 493	18 536	19 996	20 787	21409	22 157	23 429	1.0	13.8	7.0	3.5	5.7
Uruguay	5 888	6 330	6 994	7 383	7 166	7 697	7 915	8 201	35.9	21.2	7.1	2.3	3.6
Venezuela	34 833	34 684	34 785	35 110	35 845	38 218	39 853	38 888	24.7	4.0	0.2	4.3	-2.4
Mexico [e]	**102 400**	**100 900**	**95100**	**101900**	**114 900**	**114 000**	**127 600**	**135 500**	**30.2**	**11.9**	**1.2**	**7.8**	**6.2**
Central America and the Caribbean	**33 113**	**34 055**	**37 313**	**38** 364	**37 286**	**37 651**	**37 717**	**38 504**	**18.8**	**15.3**	**6.6**	**-0.6**	**2.1**
Costa Rica	4 384	4 470	**4** 488	**3** 930	4 015	4 050	4 046	4 200	12.8	14.7	1.5	1.0	3.8
El Salvador °	1743	1769	**2** 017	**2** 076	2 102	2 338	1988	2 053	17.7	3.0	2.8	-1.4	3.3
Guatemala[c]	2 465	2 340	**2** 457	**2** 387	2 254	2 246	2 086	2 108	19.0	20.4	2.5	-4.4	1.1
Haiti[0]	752	778	803	841	809	819	864	884	21.0	21.7	6.2	0.9	2.3
Honduras	3 773	3 810	**3** 374	**3** 547	3 174	3 538	3 948	4 069	17.5	16.7	7.3	3.6	3.1
Jamaica	4 014	4 002	**4** 038	**4** 152	3 874	3 678	3 647	3 660	22.6	14.9	5.2	-4.2	0.4
Nicaragua [c]	6 270	7 220	**9** 741	10 616	10 312	10 806	10 987	11695	27.1	21.5	15.9	1.2	6.4
Panama [c]	3 731	3 771	**3** 814	**3** 795	3 699	3 548	3 494	3 663	**9 0**	i t s	***0 7***	-2.7	A Q
	5 899	5 883	**4 181**	**4 500**	4 614	4 413	4 559	3 922	24.2	14.0	4^5	0^4	-u.o
Trinidad and Tobago	2 082	2 012	2 400	**2** 520	2 433	2 215	2 098	2 250	29.3	16.3	8.5	-5.9	7.2

Source: ECLAC, on the basis of official figures.

[a] Includes debt owed to the International Monetary Fund (IMF). Preliminary figures. [c] Public debt. Total debt according to official figures and data from international financial agencies. [e] The public debt does not include investment by non-residents in govemament securities. The figures on private debt between 1991 and 1993 have been adjusted to account for the privatization process and the abolition of the system of foreign-exchange controls.

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However, the Dominican Republic reduced this amount significantly, by 14%, chiefly by restructuring its external commercial debt under the Brady Plan. Moreover, only four countries had fairly sizeable increases in their debt. In Colombia (16%) and Chile (11%), this was due to a sharp growth of private-sector debt, since in both countries the public-sector external debt decreased. On the other hand, in Bolivia (10%), the expansion was rooted mainly in the public sector. In Argentina the debt rose 10%, with public-sector debt apparently accounting for a higher proportion of the increase. In another six countries -Ecuador, Mexico, Nicaragua, Panama, Peru and Trinidad and Tobago- the debt rose by between 4% and 7%, with the public sector having the largest share. The other Latin American countries showed minor changes.

In 1994 the secondary debt market reacted unfavourably to the events in Mexico and Venezuela. Likewise, the price of debt instruments declined in Argentina, and, towards the end of the year, in Costa RÍCÍ , Ecuador and Panama. On the other hand, as a r< ¡flection of the continuing process of recovery from a decade of debt crisis, secondary debt-market prices remained stable during the year in Jamaica, Colombia and Chile (at 83%, 90% and 95%, respectively), and during the sîcond half in Brazil and Peru (42% and 55%, respectively) (see table IV-21).

b) **The debt burden**

The region's debt load continued to decline, as it had since 1987. The ratio of interest payments on the external debt, to lotal exports of goods and services was 18%; in .982-1983 this figure had approached 40%. In L994, only six Latin American countries (Chile, <Hosta Rica, the

Table IV-21

LATIN AMERICA: PRICES OF EXTERNAL DEBT PAPER ON THE SECONDARY MARKET

(As a percentage of face value)

	1991			1992			1993			1994		
	January	June	De-cember	January	June	De-cember	January	June	De-cember	January	June	De-cember
Argentina	19	25	36	39	50	45	45	52	66	70	53	45
Bolivia				13	12	16	16	16				
Brazil	23	33	30	32	37	28	30	38	46	41	42	
Chile	75	88	89	89	90	91	91	91	93	95	95	95
Colombia	64	73	81	75	75	75	75	75	85	85	90	90
Costa Rica	34	46	50	51	57	60	60	67	81	83	67	63
Ecuador	20	22	22	24	32	27	28	33	52	50	41	30
Honduras				26	27	34	33	31	31	32	35	36
Jamaica				75	74	67	69	76	76	78	83	83
Mexico	45	55	60	62	65	65	66	72	82	83	66	62
Nicaragua				6	9	6	8	9	11	16	9	6
Panama	11	13	21	23	33	29	29	32	56	70	55	55
Peru	3	7	11	14	17	18	19	33	67	73	50	58
Dominican Republic					33	32	31	41	57			
Uruguay				70	70	75	75	72				
Venezuela	50	60	66	67	61	57	58	67	72	72	53	48
Average [a]	32.5	41.5	45.0	47.6	52.2	47.9	47.7	53.9	63.2			

Source: United Nations, Department for Economic and Social Information and Policy Analysis, on the bisis of asked prices compiled by Salomon Brothers and by Merrill Lynch.

* Weighted by the amount of bank debt.

Dominican Republic, El Salvador, Guatemala and Paraguay) showed interest/exports ratios of around 10% or less, a figure which most analysts consider acceptable. All the other countries still have ratios exceeding that figure, including four with ratios above 20%: Nicaragua (100%), Argentina and Mexico (24%) and Peru (21%) (see table IV-22).

The decrease in the interest/exports ratio in 1994 was the result of the robust expansion of exports of goods and services, which far outstripped the growth in interest payments. External sales[1] rose from US$ 165 billion in 1993 to US$ 190 billion in 1994, while net payments of interest and profits increased from US$ 33 billion to US$ 34.2 billion, partly because of the rise in international interest rates (UBOR applicable to variable-rate external debt increased from 3.5% in 1993 to 3*9% in 1994). Other factors Contributing to this growth in net payments were the expansion of the external debt, higher profits remittances and, in the case of bond sales, increased brokerage costs.

Owing to the moderate expansion of the external debt and the robust growth of exports, Latin America registered an improvement in its debt/exports ratio, to 276%, which was very similar to what the region's ratio had been prior to the debt crisis (see table IV-23).

All of the region's countries except Haiti showed positive trends in this indicator in 1994. The figures for Nicaragua and Haiti are so extreme (2,600% and 1,200%, respectively) that they will undoubtedly require special measures, including forgiveness of significant external-debt amounts. The indicators for Peru (415%), Argentina (404%), Honduras (367%) and Bolivia (356%) were also very high. The Peruvian Government is negotiating for the restructuring of its commercial debt within the Brady Plan framework, which will probably take place in 1995. Argentina has gradually reduced this indicator since 1987, when it reached an unprecedented 717%.

A group of countries, consisting of Brazil, Ecuador and Uruguay, had ratios of between 310% and 260%; in recent years, all these economies have consistently reduced this ratio. Mexico's ratio of 270% has tended to stabilize during the most recent five-year period. Lastly, the countries with more ample debt/exports ratios include Venezuela (223%), Colombia (179%) and, especially the Dominican Republic (155%), El Salvador (154%), Chile (152%), Costa Rica (126%), Guatema a (91%) and Paraguay (46%).

The debt/GDP ratio continued to show a downward trend, reaching 32% in 1994, a level substantially lower than the 1986 figure (an unprecedented 57%), and close to the 1980 figure (28%), which can be regarded as relatively normal. In 1994 this rat io increased in Bolivia (because of increased bon owing) and in Haiti, Honduras and Venezuela (bxause of their shaky economic performance). It was relatively stable in most countries in tho region, but declined significantly in Brazil and the Dominican Republic, because a p artion of their debt was written off, and in Argentina and Peru, because of robust economic growth (see table IV-24).

The debt/GDP ratio remained ebove 50% in Bolivia, Ecuador, Panama, Uruguay and Venezuela, although most of these countries have seen significant declines from level 5 approaching 100%. Extraordinarily high ratio! persisted in Honduras (125%), and especially Nicaragua, where the amount of the debt continued to be six times the value of GDP.

c) Debt renegotiations

In August 1994 the Govern nent of the Dominican Republic finalized the provisional agreement concluded in 1993 for the rescheduling of its debt to commïrcial banks. The agreement combines the usual Brady Plan terms with an additional option, which allows for greater debt reduction, and encompasses US$ 1.25 billion in principal and interest arrears. The list of principal options include;»: repurchase at 25% of face value; a discount bond with a 30-year repayment period and 30 yîars'grace, a 35% discount and an interest rate or 0.81% over UBOR; and an 18-year par bond with nine years'

'These figures include only net income from the maquiladi industry.

Table IV-22

LATIN AMERICA AND THE CARIBBEAN: TOTAL INTEREST AS A PERCENTAGE OF EXPORTS OF GOODS AND SERVICES[a]

(Percentages)

	1986	1987	1988	1989	1990	1991	1992	1993	1994[b]
Latin America and the Caribbean	**36.4**	**30.3**	**28.8**	**28.3**	**25.1**	**23.1**	**20.4**	**19.7**	**18.1**
South American countries	**37.6**	**31.4**	**29.3**	**29.3**	**26.3**	**23.6**	**19.6**	**18.5**	**16.3**
Argentina	50.9	50.9	42.0	51.2	38.0	36.2	28.3	22.5	23.6
Bolivia	42.1	38.4	41.0	30.2	25.0	26.9	24.4	20.8	15.4
Brazil	42.4	33.1	29.4	29.2	31.4	27.6	20.9	21.6	16.8
Chile	37.1	26.4	21.7	18.6	17.9	14.8	11.3	10.2	8.5
Colombia	20.5	20.5	20.7	21.7	19.0	16.4	14.5	12.0	13.1
Ecuador	29.7	32.5	32.5	33.7	29.3	25.0	19.4	17.5	19.5
Paraguay	15.4	21.0	12.5	7.1	5.2	5.1	8.8	3.6	3.1
Peru	28.9	25.1	26.7	22.5	27.1	26.5	22.9	24.6	21.2
Uruguay	24.6	24.2	24.0	27.2	26.8	21.2	16.3	15.3	15.1
Venezuela	34.2	25.9	29.0	26.6	17.0	15.4	18.2	17.4	15.9
Mexico	**38.0**	**29.8**	**30.0**	**28.2**	**24.2**	**23.4**	**23.4**	**24.1**	**24.0**
Central American and Caribbean countries	**19.7**	**19.9**	**18.7**	**16.9**	**15.7**	**14.6**	**15.9**	**13.5**	**11.6**
Costa Rica	21.8	21.3	22.0	23.6	15.4	10.0	8.6	7.4	6.4
El Salvador	10.1	10.9	9.5	8.8	13.0	12.5	10.5	10.3	7.0
Guatemala	17.4	13.6	13.9	11.3	11.2	7.1	8.8	6.2	5.6
Haiti	5.1	6.0	8.2	9.5	8.7	9.9	7.1	7.5	12.0
Honduras	15.3	18.7	17.6	17.6	17.9	21.1	25.9	23.6	18.0
Nicaragua	88.5	75.6	96.7	62.1	58.3	110.3	158.5	115.6	103.9
Dominican Republic	18.8	20.3	14.7	11.1	12.2	8.1	8.3	8.6	7.5

Source: ECLAC, on the basis of figures from the International Monetary Fund (IMF) and from national sources.
[a] Includes interest payments actually made and interest due but not paid. Services do not include factor servic< s. [3] Preliminary figures.

grace and interest rates of 3% in the first two years, 3.5% in the third and fourth years, 4% in the fifth and sixth years, and 0.81% over LIBOR in the following years. The discount bonds are backed by a United States Treasury zero-coupon bond and a renewable interest guarantee; the par bonds are not guaranteed. With regard to the interest arrears, 12.5% must be paid in cash, and the rest converted into 15-year bonds with an interest rate of 0.8125% over LIBOR. Upon the signing of the agreement with foreign private banks in August 1994, the debt balance was reduced from US$ 1.25 billion to US$ 520 million, of which US$ 329 million was automatically redeemed through zero-coupon bonds. The only outstanding payment obligation to commercial banks amounts to US$ 191 million. Thus, the country obtained a debt reduction of US$ 1.058 billion.

In October 1994, Ecuaior signed a rescheduling agreement for its external commercial debt within th; Brady Plan framework which included US: 5 4.5 billion in principal, US$ 2.3 billion in inte rest arrears and US$ 800 million in overdue interest. The list of principal options included a discount bond with a 30-year repayment period and 30 years' grace, a 45% discount and an interest ra ;e of 0.81% over LIBOR, and a par bond with a 30 year repayment

Table IV-23

LATIN AMERICA AND THE CARIBBEAN: TOTAL DISBURSED EXTERNAL DEBT AS A PERCENTAGE OF EXPORTS Of GOODS AND SERVICES

(Percentages)

	1986	1987	1988	1989	1990	1991	1992	1993	1994 [a]
Latin America and the Caribbean	**427**	**400**	**342**	**311**	**295**	**305**	**298**	**301**	**276**
South American countries	**426**	**416**	**341**	**316**	**302**	**310**	**306**	**308**	**279**
Argentina	610	717	525	538	412	443	439	431	404
Bolivia	530	658	603	403	386	390	490	423	356
Brazil	460	430	315	307	356	360	340	340	308
Chile	398	327	229	183	182	157	153	166	152
Colombia	248	257	267	241	206	191	183	186	179
Ecuador	**345**	422	400	394	364	360	334	545	306
Paraguay	244	269	182	129	90	88	71	50	46
Peru	430	428	447	423	491	494	494	,509	415
Uruguay	347	371	361	344	342	326	304	:(09	260
Venezuela	356	305	314	248	187	219	246	:»55	223
Mexico	**456**	**372**	**348**	**288**	**265**	289	**275**	:i85	271
Central American and Caribbean countries	**334**	**350**	**332**	**347**	**345**	**326**	**312**	**;84**	**260**
Costa Rica	292	302	276	244	199	182	156	135	126
El Salvador	174	192	188	248	236	233	240	175	154
Guatemala	**216**	217	184	173	152	134	118	103	91
Haiti	238	235	283	339	345	324	650	120	1179
Honduras	333	397	371	318	344	313	340	370	367
Nicaragua	2 **005**	1932	2 644	2 859	2 707	3 048	3 494	2S92	2 629
Dominican Republic	269	249	204	201	224	233	211	195	155

Source: ECLAC **on the basis** of figures from the International Monetary Fund (IMF) and from national sources.
" **Preliminary figures.**

period **and** 30 years' grace and gradually **increasing interest** rates of 3% to 5%. **Approximately 58% of** the country's creditors **opted for the discount** bonds, and 42% chose the **par bonds. The bulk** of **the** interest will be paid over **a** 20-year period, with 10 years' grace, at **interest rates** of 0.81% over UBOR. Overall **commercial debt reduction** is estimated at 31%. **In order to finance the** restructuring (purchase of **United States Treasury** zero-coupon bonds), the **country received support from** the International **Monetary Fund, the** Inter-American **Development Bank and the World** Bank, with **which it signed a structural** adjustment **agreement.**

During the early months of 1!>95, Panama and Peru pursued negotiations for the restructuring of their debt to commercial banks within the Brady Plan frame work. The recognition by the Peruvian legislature of a debt to a United States bank and the announcement by creditor banks in mid-December that they were abandoning judicial proceedings instituted against the Government of Peru in 1990 constitute important steps towards an agreement.In 1994, only Ecuador and Guatemala restructured principal owed to the Paris Club, worth US$ 390 million and US$ 73 million, respectively.

Table IV-24

LATIN AMERICA AND THE CARIBBEAN: TOTAL EXTERNAL DEBT AS A PERCENTAGE OF GROSS DOMESTIC PRODUCT [a]

(Percentages)

	1986	1987	1988	1989	1990	1991	1992	1993	1994 [b]
Latin America and the Caribbean	57	56	49	43	41	41	38	37	34
South American countries	51	50	45	41	39	39	38	37	32
Argentina	50	56	50	70	43	34	29	27	28
Bolivia [c]	154	119	103	82	68	59	63	62	68
Brazil	40	41	34	25	28	32	35	33	25
Chile	118	99	79	64	62	52	47	46	47
Colombia	47	44	43	43	42	41	32	32	31
Ecuador	78	101	114	116	119	113	105	90	71
Paraguay	63	68	62	46	32	27	20	18	17
Peru	52	40	51	52	62	48	51	54	46
Uruguay	92	80	84	89	89	75	65	60	54
Venezuela	70	67	64	85	74	69	65	67	69
Mexico	80	**73**	**58**	**46**	**42**	**40**	**35**	**35**	**37**
Central American and Caribbean countries	76	77	79	83	85	76	69	65	61
Costa Rica	92	96	94	85	68	70	59	52	50
El Salvador [c]	43	36	30	33	38	34	34	26	24
Guatemala [c]	35	34	30	30	30	24	21	18	16
Haiti [c]	50	68	73	78	54	48	50	54	60
Honduras	86	87	92	92	128	108	109	121	139
Nicaragua	256	227	474	929	677	648	574	610	658
Dominican Republic	69	70	74	57	58	55	45	45	53
Panama	74	70	82	82	76	67	59	53	52

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

[a] Estimates of gross domestic product in current dollars were arrived at on the basis of GDP data expressed in local currency and the exchange rate applying to exports of goods and services. Preliminary estimates. Extenal public debt as a percentage of gross domestic product.

V. ECONOMIC TRENDS IN THE CARIBBEAN

1. Main features of recent trends

The pace of economic activity in the English-speaking Caribbean subregion[1] picked up by 3.8%, after the sluggish performance of the previous three years. Per capita output expanded, in a change from the cumulative decline experienced since the early 1980s. The recovery was widespread, although it was more noticeable in some of the larger economies of the subregion (see table 1). Inflation trends, however, were mixed, slowing in some countries, notably Trinidad and Tobago, and accelerating in others, such as Guyana, Jamaica and above all Suriname, where it rose 350%. Economies that had enjoyed relatively low rates of inflation were generally able to hold the line, although there were slight increases in some countries.

The trade balance improved for the Caribbean countries as a whole, with exports expanding by 8% and imports by a little under 4%. Since services, particularly income from tourism, also increased satisfactorily, the overall current account deficit declined by 23%. Net capital flows were generally positive, although in many cases lower then the year before. Private capital flows, attracted by exchange and interest rate liberalization measures adopted earlier, predominated in the larger countries. In other countries, however, notably Guyana and Suriname, the trend was unfavourable, characterized by a sharp drop in capital inflows in the first and a net outflow of capital in the second. None the less, the volume of international reserves increased for the subregion as a whole and for most countries individually. Public finances continued to be one of the major concerns of Caribbean Governments, despite the fact that some economies had to struggle with heavy debt service payments and high cost of controlling liquidity.

In 1994, economic policy continued to be focused on stimulating the output of export products while providing support for the most vulnerable members of society, There was growing consensus among the Governments of the subregion on what the content of economic policy should be. Implementation ol'policy in the individual countries, however, was far from satisfactory, either because of the magnitude of the disequilibria they had experienced and the consequent adverse social effects, or because of a lack of speed and consistency in applying corrective measures.

Initiatives to meet the above objectives were taken in three different arenas. The first was domestic macroeconomic policy, where the focus was on providing a framework within which the private sector could become more competitive. Attention remained centred on fiscal and monetary policy and the real exchange rate, although there were setbacks in some instances when political considerations outweighed economic objectives. Trade policy was another area of concern, with att< ntion aimed at eliminating anti-export biases and promoting efficient use of domestic resources; however, actions on the national level often had to be coordinated with subregional agreements.

[1] **The expression** "English-speaking Caribbean" is a succinct way of referring to the following countries and ti :rritories in the **Caribbean subregion for** which **data** were available: Antigua and Barbuda, the Bahamas, Barbados, Belize, British Virgin Islands, **Dominica, Grenada, Guyana,** Jamaica, Montserrat, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, and **Trinidad and Tobago. The Dutch-speaking** countries of Aruba, Netherlands Antilles and Suriname are also included. Countries **for Which sufficient information** was not available have been excluded.

Measures were also gradually taken to liberalize foreign exchange regimes, encourage the repatriation of flight capital, attract flows of private external capital and facilitate transactions between Caribbean countries.

The second arena of action was on the regional level, where initiatives were taken to consolidate markets within the framework of the Organization of Eastern Caribbean States (OECS)[2], the Caribbean Community (CARICOM)[3] and the wider Association of Caribbean States (ACS)[4]. Over the longer term, the Caribbean countries also considered integration into a broader hemispheric market within the framework of the Free Trade Area of the Americas. Among the anticipated benefits to be derived from market consolidation were the gradual exposure of local agents to external competition, the development of economies of scale wherever feasible and the identification of complementarities within the wider market. Progress toward market consolidation at all levels was slow, however, since many feared that Caribbean firms would be unable to compete in wider regional or global markets, while the beneficiaries of protection sought to retain it. Moreover, there was apprehension that greater specialization by each of the small Caribbean islands would increase the risk entailed in concentrating on the production of just a few products.

Finally, the third arena of action was related to concern over growing disparities between citizens as a result of the recent recession and economic restructuring. Efforts were therefore made to obtain better statistics on poverty and to strengthen social policies in sustainable ways, especially in the areas of health and education, in order to achieve the twin goals of greater equity and human productivity.

The growth in output experienced by nearly all the countries was due primarily to consistent macroeconomic policies and a relatively favourable external environment. A notable acceleration of the economic pace was observable in Aruba, Barbados, Guyana -continuing its strong performance of the previous three years- and Trinidad and Tobago. The OECS countries as a group experienced moderate growth; in Anguila, Antigua and Barbuda and Grenada there was significant growth, while the pace of expansion slowed in the other countries. Belize and Jamaica also had lower rates of growth. Suriname, finally, suffered severe economic disequilibrium and struggled to find the appropriate instruments to contain runaway inflation.

Aruba resumed vigorous growth after a modest performance in 1993, when it had adopted a restrictive policy in an effort to reduce inflation. In 1994 its economy was enlivened by dynamic construction activity in the tourist and petrochemical sectors and in infrastructure. The number of tourists again rose, by 3.6% this time, but the free zone turned in a poor performance. The current account surplus nevertheless increased, thanks to the contribution of the petroleum sector, although the total balance-of-payments surplus contracted because of increased profit remittances. The prime objective of curtailing inflation vas achieved in part, since inflation fell from 6.5% to 4% in 1994. Concerns remained, however, because Aruba's inflation rate, stemming mainly from a tight labour market and excess domestic demand, exceeded that of its main trading partners. Unemployment had dropped from under 1.5% in 1989 to 0.5% or less in 1991 and maintained that level thereafter. Macroecononic policy was therefore directed at impioving labour productivity in all sectors and particularly in the public sector.

After three consecutive year» of decline, the economy of **Barbados** revived in 1994 following a hesitant start in 1993. Unemployment declined from 24.7% to 21%. The incnased tempo of

The OECS is made up of Antigua and Barbuda, the British Virgin Islands, Dominica, Grenada, Mons< rrat, Saint Kitts and Nevis, Saint Lucia and Saint Vincent and the Grenadines. For the purposes of this study, the totals given fir OECS also include Anguila, which, while not a part of the OECS, is a member of the Eastern Caribbean Central Bank.

The members of CARICOM are the Bahamas, Barbados, Belize, Guyana, Jamaica, Trinidad and Tobaj o, and the countries belonging to the Organization of Eastern Caribbean States (OECS).

4 The ACS is composed of the member States of CARICOM plus the Central American countries, Cuba, 1 [aiti, the Dominican Republic, Mexico, Colombia and Venezuela.

Table V-1
CARIBBEAN COUNTRIES: TOTAL GROSS DOMESTIC PRODUCT
(Annual percentage change) [a]

	1987	1988	1989	1990	1991	1992	1993	1994[b]
Total subregion	0.6	1.3	3.1	3.1	1.3	0.6	-0.5	4.7
Antigua and Barbuda	9.0	7.7	6.3	3.5	4.3	1.7	3.4	5.3
Bahamas	4.6	2.3	2.0	4.8	-3.2	1.0	2.4	
Barbados	2.6	3.6	3.7	-3.2	-4.2	-5.9	0.8	4.0
Belize	11.8	6.3	13.2	10.3	3.0	11.3	3.6	1.6
Dominica'	6.8	7.4	-1.1	6.4	2.3	2.8	2.6	1.8
Grenada	9.3	2.4	5.8	5.2	3.6	1.1	-1.3	2.3
Guyana	3.8	-2.3	-4.8	-2.7	5.8	7.4	8.0	8.5
Jamaica	7.7	3.9	8.5	6.5	3.2	2.2	0.0	0.8
Saint Kitts and Nevis	7.5	9.8	6.7	3.0	3.8	3.0	4.5	4.1
Saint Lucia	1.7	12.7	8.5	4.4	2.3	7.1	2.3	2.2
Saint Vincent and the Grenadines	6.3	8.6	7.2	7.0	3.1	6.5	1.4	0.4
Suriname	-6.2	7.8	4.2	0.1	3.5	5.8	-4.5	-0.8
Trinidad and Tobago	-4.9	-3.1	-0.4	1.9	1.7	-2.3	-3.0	4.4

SÒurCe: ECLAC, on **the** basis of official figures converted into dollars at constant 1980 prices.
[a] **Calculated** on **the** basis of figures in dollars at constant 1980 prices. Preliminary figures.

activity was due primarily to the expanding sugar sector (6%), manufacturing (7%) and tourism (9%). These activities also contributed to increased export earnings, which, together with greater foreign direct investment and external borrowing by the Government, helped to rebuild international reserves. Monetary policy focused on containing rising demand, and prices remained stable. Fiscal policy was weaker, however, and the deficit was larger than those recorded In the previous two years.

Guyana experienced expanded output of 8.5%* « repeating its excellent performance in 1993l©rowth was notable in agriculture (12%), industry (9%), with a 6% increase in manufacturing)andservices (nearly 6%). Export earnings were also up, thanks to increased foreip sales of bauxite, rice, shrimp and gold, while sugar exports levelled off. The resulting influx of foreign currency fuelled a number of domestic activities, particularly among the service industries. At the same time, the fiscal situation improved and the pace of monetary expansion slowed. The national debt continued to be a serious obstacle to the country's development by making it hard to obtain financing to expand infrastructure and production capacity.

In Trinidad and Tobago the economy grew by a little over 4% after a long period of decline; between 1983 and 1993 GDP grew only in 1990 and 1991. The recovery was led by the petroleum and petrochemical sector, which expanded by over 8%. Other sectors, notably sugar and construction, experienced more modest growth. The economic upturn improved the balance of payments and increased fiscal revenues, so that more could be spent on alleviating some of the most painful effects of the recent adjustment programme. Economic recover) also had a positive impact on the labour market, so that unemployment declined. The hflation rate slowed from a annual average of i:.% in 1993 to 9% in 1994.

Jamaica experienced modest giowth in 1994 (2.5%), thanks to an expansion in mining and agriculture, although growth in th<: latter sector was not as strong as the yi;ar before. Manufacturing and construction contracted as a result of work stoppages, a slow-do^ vn in tourism and high interest rates that discouraged investment. Merchandise trade performance improved, but earnings from tourism declined. High interest rates attracted a grei ter influx of capital, and reserves increased significantly. Monetary policy was orientdd towards controlling inflation, and tight money led to high interest rates, which in turn put a strain on the fiscal budget, in addition to their above-mentioned impact on the external accounts. Fiscal management remained problematic and was further complicated by the need to handle the debt and to cover losses by the central bank. Although the annual average rate of inflation was higher than for the previous year, the monthly rate dropped progressively during the last five months of 1994 in response to a consistent monetary policy and exchange rate stability.

Belize experienced a declining rate of economic growth for the second consecutive year, partly because of cuts in government spending and related construction activities in an effort to reestablish fiscal balance and partly because of the withdrawal of British troops, which had been contributing nearly 4% of output. On the other hand, agriculture and manufacturing expanded and the service sector also did well, particularly transport, communications and tourism. Overall, fiscal performance improved slightly, but at the cost of a severe cut in capital investment, while current expenditures continued to increase. The rate of expansion of domestic credit also slowed, though it remained predominantly directed to the public sector, and this may have dampened the demand for imports. Consequently, the balance of payments improved slightly, the main increases being in the merchandise account, so that the erosion of reserves was arrested. Inflation continued to be very low.

The output of the OECS countries as a group increased at a rate of 2.8%, better than the figure of 2.2% for 1993, but well below the average of 6.6% recorded for the period 1988-1990. Growth was driven by services, mainly tourism and construction, while agriculture and manufacturing did poorly. Within the group performance varied. The most rat id growth was observable in Antigua and Grenada, the latter rebounding from a recession year. Growth slowed in Dominica, Saint Kitts and Nevis and Saint Vincent and the Grenadine s, levelled off in Saint Lucia and was negative in Monserrat. The island of Anguila, not a pari of OECS but a member of the Eastern Caribbean Central Bank (ECCB), turned in a good perfor nance for the third consecutive year thanks to growth in tourism.

The economic instability observable in **Suriname** in 1993 persisted in 1994. Output declined for the second year running, reflecting primarily a contraction in agriculture and government activities, while inflation and devaluation accelerated. The rats of monetary expansion jumped from 72% in 1993 to 167% in 1994. Rapid money creation was due to fiscal deficits (including central bank losses incurred through a policy of multiple exchange rates) equal to 19% and 13% of output in 1993 and 1994, respectively. Although the central government deficit remained roug hly the same in both years at 8% of output, central bank losses descended to 5% of output in 1994 from nearly 12% in 1993, thanks to the unification of the exchange rate in June 1994. Ii the external accounts, the current account balance improved. Exports declined, but imports declined even faster as a result of the new exchange rate, and official and private unrequited transfers increased. Capital outflows ami debt service payments produced a small defic it in the overall balance of payments, which was financed by drawing down gross reserves.

2. Fiscal policy

Fiscal and monetary policies remained the key instruments for short-term economic management. Most governments recognized the importance of adhering to conservative fiscal policies to enable their economies to increase the rate of investment in productive activities. The concept of shifting the main source of revenue away from taxes on income, profits and international trade to taxes on consumption gained new adherents, while efforts to reduce current spending continued, th; focus in the smaller countries being placed on controlling the persistent growth of wages. There was also growing consensus on the need to orient government spending to basic soc ial services and the rehabilitation of infrastructuR. This clarity of purpose; however, was complicated by the legacy of previous fiscal laxity in the form of heavy debt service and liquidity management costs. Concern continued to be expressed about the state of some key social services, especially health and education, and policy debate continued about the appropriate pace and means of correcting the situation. Natural disasters and the vagaries of the political arena created further reasons for relaxing fiscal discipline.

Fiscal performance deteriorated somewhat in the DECS countries. Gains made in 1993, when the overall budget deficit was reduced from 2% to 1¿3% of output, were eroded in 1994 as the déficit rose 1.9%. Much of the setback, however, was due to a 12% decline in capital revenue. Current revenue increased in line with growth in activity, remaining at just over 24% of output. Contributing factors were the economic recovery in 1994 and greater efforts at collection. Consumption taxes increased as a proportion of total, taxes and now represent 45%. Current expenditure also increased slightly to 22% of product, the main component being wages and salaries, which increased by over 5%. As a result, the current surplus declined from 2.7% in 1993 to 2.2% in 1994. While Antigua and Barbuda achieved a current account surplus, after a deficit in 1993, the reverse was true in Dominica, and most of the other countries had reduced surpluses. Capital investment as a percentage of output remained the same and went mainly to the development of infrastructure.

Belize improved its fiscal performance in 1994, reducing its deficit, excluding service on the debt, from 6% of output the previous year to a lMeover 2% in 1994. It achieved this result by a sharp cut in capital expenditure from 15% of output ta 1993 to 9% in 1994. Current expenditure rose from a little over 23% of output to nearly 25%. Spending on wages and salaries wentup 12%, while interest payments increased from 5.7% to *9%* of current expenditure. Total revenues and grants rose marginally in nominal terms but declined from 31% to 29% as a percentage of output. Current revenue grew only marginally and remained at around 28% of output. Taxes on internatioral trade and transactions grew by over 4% and continued to represent a high percentage, in this case 48%, of current revenue. Capital revenue, chiefly from sales of assets, declined, while grants increased.

In Barbados, fiscal performance changed little from 1993. Excluding debt service payments, the deficit shrank slightly to just over 2% of output. Current revenue jrew by 4.4%, spread evenly among the major taxes, while current expenditure increased ty 5%. Major areas of growth in spending were employee remuneration (5%), debt interest and principal repayments (nearly 9%), and gooes and services (17.5%). Overall expenditure increased only 3.6%, however, because of a cut o F nearly 9% in capital expenditure.

In Jamaica fiscal performance was weighed down by the debt service burden and the cost of monetary policy. Debt interest and principal repayments absorbed nearly 83% (f government revenues, or over 27% of output, compared with 49% of revenues and 16% of outpul in 1993.[5] The effort to achieve a primary surplus of 8.6% excluding debt servicing was commendable but ultimately insufficient to preveni a deficit of nearly 19% of output after meeting debt obligations. Total revenue increased from 32% to 35% of output, although the ratio of tax revenues to output remained stable at 28%. Consumption tax accounted for nearly 30% of tax revenues, the same proportion as in 1993 and a 10% increase over the percentage in fiscal 1991/1992, the year in which it was introduced.

Privatization of public sector enterprises continued in Jamaica, although sale was completed on only five of the 2) enterprises selected: four agricultural enterprises and the national airline. The privatization of the airline contributed to the debt service problem, since accumulated arrears had to be cleared before the airline could be transferred to private operators. Expenditures other than debt service payments increased from 22% of output to just over 24%. Gross investment increased from

[5] The high level was due largely to the inflationary of nominal interest rates.

over 5% of output to nearly 7% and was spent primarily on infrastructure. Current expenditure, excluding interest, increased slightly to 16% of output, in part because of unforeseen personnel costs.

In **Guyana** fiscal accounts were burdened by large debt service payments and the considerable cost of controlling excess liquidity. Interest and principal repayments absorbed 82% of current revenue in 1994, compared to 76% in 1993, a figure that still appeared modest compared to 114% in 1992. Current revenue increased by 9%, although it was lower than projected because of a shortfall in the collection of customs and excise taxes. Capital revenues, 33% of which came from privatizations, increased by approximately 220%. Current expenditure, excluding interest payments, increased 9%, chiefly in public sector wages and salaries. Allocations for health and education increased in 1994, accounting for 14% and 17%, respectively, of current expenditure.

Trinidad and Tobago consolidated its fiscal adjustment. The deficit of nearly 3% of output in 1992 was virtually eliminated it 1993, and the balance was maintained in 1994. The rate of increase of current revenue declined, due mainly to a slow-down in the growth of p îtroleum sector revenues, which rose by bardy 2%, while non-petroleum revenues rose newly 12%. This confirmed a definite trend, si: ice petroleum sector revenues as a proportion of current revenue fell from 41% in 1990 to 25% in 1994. The chief boosters of tax revenues were income tax (up 10%), property tax (up 50%) and value-added tax (up 8%), while n< >n-tax revenues increased by 33%. Expenditure increased by nearly 9%; transfers and subsidios increased by 12%, with transfers to households rising 34%, including severance pay and retirement benefits to public employees affected by cut-backs. Government consumption expenditure increased 48%, reflecting among other things the doubled cost of the school meal programme and a 7% increase in interest payments. Capital expenditure rose 20% and went primarily to road improvement, health care, primar *y* education and infrastructure for squatter settlements.

3. **Trends in the main variables**

a) Economic activity

i) ***Agriculture.*** Agriculture continued to be affected by adverse weather conditions and unpredictable markets for the main export crops. The situation was exacerbated by the low competitiveness of bananas and sugar from the OECS countries. Belize, Guyana, Jamaica and Trinidad and Tobago, however, ran counter to this discouraging trend and had a good year in 1994.

Agriculture did well in **Belize,** with increases in sugar, citrus and banana production. Forestry and logging also expanded, but the shrimp catch declined. In **Jamaica** agricultural production for domestic consumption continued to make great strides and benefited to some extent from the recent exchange rate depreciation. The performance of export crops was mixed, however; earnings from bananas and non-traditional exports increased, while sugar earnings declined, because of lorward selling of the 1994 crop in 1993 and *i* smaller sugar cane crop; coffee output also declined. In **Trinidad and Tobago** agriculture significantly increased its contribution to output, led by sugar, which made up for two years of decline. Agricultural production lor domestic consumption also expanded, although at a more modest rate.

In Barbados, the decline in agricultural output observable since 1990 persisted, but eased somewhat thanks to a slight improvement in sugar. Fishing, agricultural experts and cotton also grew marginally. Agricultui al output in the OECS countries declined for the second consecutive year. Banana production fell in all four producing countries becaase of adverse weather conditions throughout the year. Problems with market arrangements created further uncertainty in the industry and

As in the case of Jamaica, these high percentages are attributable to the inflationary component of nomi nal interest rates.

encouraged some switching to other export fruit crops. Other traditional export crops, such as sugar, cocoa and nutmeg, were also affected by bad weather, which reduced output.

ii) Manufacturing. The manufacturing sector in the Caribbean has encountered serious problems in recent years, and there is still no clear indication that it has overcome them. One problem was that the replacement of an import-substitution development model with a model emphasizing trade liberalization and export orientation caused dislocation, since enterprises were geared to local markets. Another problem was that some traditional manufacturing activities Involving the processing of traditional export crops, particularly sugar, suffered a decline along with the agricultural export crop on which they were based. In some countries where the adjustment process was well established, manufacturing expanded into areas such as garment assembly. The development of a strong, export-oriented manufacturing sector remains the goal of much current policy, since it is considered the most likely means of absorbing technological innovations and integrating the growing youth population.

Manufacturing contributed some 16% of output in Belize, close to the regional average. To a large extent it involved processing of agricultural products, and this segment remained diverse and dynamic, exporting sugar, molasses, bananas, citrus fruits and marine and forestry products. There was also a significant segment involved in assembly activities. The sector experienced broad-based growth in 1994.

In Jamaica the manufacturing sector experienced its second consecutive year of overall contraction, although some export-oriented branches did better. Manufacturing felt the negative impact of tight monetary policy and high nominal interest rates, frequent work stoppages, rising labour costs and increasing foreign competition. Domestic consumption of manufactured goods declined, while exports increased by over 20%, especially textiles and wearing apparel, which accounted for over 50% of thé sector's exports.

In Trinidad and Tobago the manufacturing sector is in the process of restructuring. Output for domestic consumption showed signs of lagging in 1994 in the face of increasing competition from imports, while manufacturing exports increased. Growth was strongest in steel, chemical products, cement and assembly and related industries. Activity declined, on the other hand, in food products, beverage! and tobacco, textiles and wearing apparel and printing and publishing.

The steady decline in manufacturing in **Barbados** since 1989 was reversée in 1994, with strong sectoral growth, to which all industries contributed with the exceptior of wearing apparel and chemical products. Wooden furniture production was particularly strong, but food processing, beverages, lobacco and petroleum products all performed well. The sector contributed to the increas; in exports, perhaps an indication that the country's manufactures were becoming moro competitive. The sector continued to be heavily promoted by government policy.

Manufacturing represented a smaller share of GDP in the OECS countries than in the larger islands. Most manufacturing wis based on agriculture and involved processing or packaging, although garment production and assembly of electronic components for export presaged a possible new phase of development for the sector. Manufacturing activity declined for the second consecutive year, with a major drop in 1994, primarily because of the poor performance of traditional agricultural exports, specifically sugar, bananas and soap. There was growth, however, in electronic assembly activities. Saint Lucia suffered the greatest contraction (12%), followed by Dominica (down by over 9%), while Grenada and Saint Kitts and Nevis also recorded a decline in the sector.

Hi) Petroleum and petrochemicals. **In Trinidad and Tobago** the petioleum and petrochemical sector as a whole expanded by over 8%, reversing the decline observable over the past three years. Domestic crude production increased 6% in 1993. This was ¡¡ufficient to

Does not include the petioleum and petrochemical industries, which are discussed in the next section.

reduce imports 9% and still allow exports to increase slightly. Slight increases in output were recorded for all petroleum products except fuel oil, which fell by 10%. Crude oil prices, however, were on average lower than in 1993. Drilling activity increased 80% over the previous year.

The petrochemical sector expanded by 25% after a three-year decline. The output of natural gas and fertilizers increased substantially, the latter also benefiting from improved prices. Methanol output more than doubled. The increased output coincided with the first full year of production of the second methanol plant, which went into operation at the end of 1993. Methanol exports not only increased in volume but commanded prices twice as high as in 1993, reflecting strong global demand.

iv) Mining. The minerals sector experienced strong growth in many countries after performing poorly for a number of years. Mining and quarrying operations in **Guyana** accounted for 12% of output and grew by some 6%, thanks mainly to gold, while bauxite production increased only moderately. Gold was the major export product, representing 26% of merchandise exports; earnings from gold increased by 20% in 1994. Earnings from bauxite increased 5%. Although total bauxite export volume expanded 126%, higher-priced calcined bauxite declined by 23%; the volume of dried bauxite increased by 185%.

In Jamaica, mining, which accounted for roughly 10% of output, expanded by nearly 7% in contrast to a 2.5% reduction in 1992 and virtual stagnation in 1993. The bauxite/alumina industry, the chief contributor to the sector, benefited from a sustained revival in the world aluminum market, due primarily to the general recovery of the United States economy. Bauxite production increased by over 2%. Total exports of crude bauxite, however, declined by nearly 7% because of reduced United States demand due to the accumulation of stocks and because of cancelled contracts with Russia. Alumina production, however, increased by 8%, and alumina exports by 13%. Gross earnings from bauxite and alumina increased by 17%, while foreign capital inflows to the sector increased by over 5%.

v) Tourism. The strong growth in tourism in 1993 flagged in 1994. For the subregion as a whole, the number of stopover arrivals (tourists requiring accommodation) increased by over 4%, but there were considerable differences between one country and the lext. The OECS countries, for example, record ;d increases of 11%, while the average increase for the CARICOM countries as a whole was lower than the regional average. The subregion's earnings from tourism increased 5%, while the OECS COI intries did better than average (8%). As in the previous year, the number of cruise ship visitors increased only slightly, by about 1%, a growth ate much lower than the average of 9% recoided during the period 1987-1992.

Value added in the OECS coun [ries by the hotel sector and other tourist industrie s increased 10% and managed to offset the weak performance of the agricultural sector. The only exception to the rule was in Saint Vincent and the Grenadines, where tourist arrivals declined by almost 1%, after strong growth in 1993. Stopover arrivals and earnings from tourism increased in the remaining countries, with doubl» ¡-digit growth in Anguila, Grenada and Saint Lucia.

The performance of the remaining CARICOM countries varied quite widely, from Barbados, which improved substantially over the previous year, to Jamaica, which experiînced a decline after many years of strong growth. **In Barbados** the value added by tourism incre< ised by over 9%, compared with 4% the previous year; the number of stopover arrivals increased 'r.5%, compared with 3% in 1993; and the numbîr of cruise ship visitors increased 7%, close to the average rate of growth of 7.5% in this segment the country had maintained since 1986. The tourist industry in the **Bahamas** had a lacklustre year. Stopover arrivals increased only 2%, compared to 6% in 1993. The growth figure, moreover, obscures the fact that tourist-days actually diminished by 1%, after 4% growth the year before, so that earnings increased barely 2%. The declir e in the number of cruise ship visitors reached an alarming 12%, so that the total number of touiists fell by over 6%.

Belize also had a relatively poor year, as tourist arrivals increased only ',.%, after a 13% increase in 1993. Gross earnings from tourism, however, expanded by 3%, and although the industry was still considered small and relatively unimportant, its earnings exceeded those from merchandise trade. In **Jamaica** the sector contracted. Despite continued investment -the total number of rooms increased by over 4%- stopovers arrivals did not increase and foreign exchange earnings declined. The number of cruise ship visitors also declined (-5.5%), so that the total number of tourists decreased by a little over 2%. This reversal from 1993 levels was significant, since stopover arrivals, for example, increased by 8% in 1993. The decline in 1994 was attributable to negative coverage in overseas media following episodes of violence against visitors.

In the non-CARICOM countries of Aruba, the Netherlands Antilles and the United States Virgin Islands, tourism was the dominant activity and accounted for 22% of the total market. In **Aruba** the number of tourists increased by close to 4%, nearly equalling growth in 1993, while earnings rose more than 6%. In the Netherlands **Antilles** the industry enjoyed a revival, the number of tourists increasing by 12%, going mainly to Saint Maarten, which experienced an increase of 13%, while Curaçao and Bonaire recorded increases of 6% and 1%, respectively. Fewer visitors went to the United States Virgin Islands; stopover arrivals were down by 6%, after increasing 11% in 1993. However, the number of cruise Ship visitors rose 3%, so that these islands received more cruise passengers than any other Caribbean destination with the exception of the Bahamas.

Cruise ship figures in general were highly erratic, with sizeable gains and losses recorded as cruise operators switched destinations in this highly competitive segment of the market. Several countries sought to maximize earnings, while cruise operators sought to minimize land costs and expenditure. This made for an unstable market, since it was easy for operators to switch destinations at short notice. As a result, cruise ship arrivals varied widely between destinations and accounted for a smaller share of the Caribbean market as a whole.

Tourists arrived from the three major markets in fairly equal numbers. Visitors from the United States numbered 5% more than in 1993. The best period was in the winter mont lis, when the increase was 8%, in contrast to only 3% in the summer months. Saint Lucia and Curaçao received 40% more visitors from the United States, while Antigua, Barbados, iaint Kitts and Nevis and Saint Vincent received f ;wer. Tourists from Canada increased 4%, mainly during the winter months, and showed a preference for the Bahamas, Barbados and Jamaica and especially for Curaçao and Saint Maarten. There were also more tourists from Europe (4%), es serially in the winter, when the increase was *8%*. Europeans tended to prefer the Bahamas, Babados, Cuba, Saint Lucia and the Dutch-speaking islands. Antigua and Grenada saw a greater number of European visitors, while Jamaica vas visited by 10% fewer than in 1993.

vi) *Employment*. Although unemployment remained an intractable problem lor many and in particular the larger coun:ries in the Caribbean, the employment situation improved somewhat in 1994. The smaller countries recorded lower rates of unemployment, and in some instances labour shortages constituted a short-term constraint on economi; expansion. This was the case in Aruba and to a lesser extent in Saint Kitts and Nevis. Moreover, there was a growing awarenesu that more flexible labour market policies might assist in reducing the levels of unemployment which prevail even at high points in tie economic cycle. This is particularly true for young people, who, although often well trained, experience especial difficulty entering the labour market.

In Barbados the upturn in the e« momy began to bring down levels of unemployment. An increase in the labour force and increased female participation rates obscured the extent of job creation in 1994; the major contributors, in descending order, were the service sector, government, commerce and tourism. Rates of participation in the labour force w;re 75% for men and 61% for women.

In Jamaica, despite slow grewth in the economy, employment expanded three times as fast as the size of the labour force. Nt w jobs went predominantly to men. Male unemployment, which had been rising since 1991, declined by 12% thanks to increased jobs in construction and

Table V-2
CARIBBEAN COUNTRIES: UNEMPLOYMENT RATES
(Percentages)

	1990	1991	1992	1<»93	1994
Aruba	1.3	0.3	0.5	0.5	0.5
Barbados	14.7	17.2	23.0	22.1	21.2
Jamaica	15.3	15.4	15.7	16.3	15.4
Netherlands Antilles	24.4	21.0	19.8	16.4	
Trinidad and Tobago	20.0	18.5	19.7	13.8	18.5

Source: ECLAC, on the basis of official figures.

in community, social, personal and financial services. Female unemployment also declined, though only by around 2%, as more jobs were created in services, commerce, hotels and restaurants. Women continued to have fewer job opportunities, and the same was true for young people (under 25 years of age). Private sector employment increased by 4%, while public sector employment declined by nearly 5%. Participation rates remained unchanged from the previous year at 74.6% for men and 62.4% for women. This represented a halt in the decline in the male participation rate during the previous five years.

Job opportunities expanded faster than the labour force in **Trinidad and Tobago,** so that the number of unemployed fell by 6%. As in most other Caribbean countries, unemployment among women (22%) was higher than among men (16%). Entry into the job market continued to be difficult for young people, who experienced a considerably higher level of unemployment -40% for the 15-19 age group, 29% for the 20-24 age group- than the population as a whole. Women, too, had more difficulty getting jobs, so that unemployment was higher among women (22.4%) than among men (16.3%). Services provided more than half of jobs, followed by agriculture (13%) and manufacturing (10%). Employment expanded notably in services and in agriculture, especially sugar production.

In **Aruba,** on the other hand, unemployment rates were quite low, so that policies to improve productivity and labour market flexibility were given high priority. Noteworthy were initiatives related to education and training, efforts to reduce the number of public employees by providing incentives for personnel to transí er to the private sector, measures to induce nat: onals residing abroad or currently not in the labour market to seek employment locally anc more liberal procedures for granting work peí mits.

b) **Prices**

Inflation in the Caribbean sut region in 1994 continued to be low in general, but a few countries experienced changes. Most had price increases of 5% or less, reflecting the impact of economic liberalization and niacroeconomic policies oriented to maintaininj; a stable real exchange rate, even without changing the nominal rate. The OECS countries as a group had an average weighted rate of inflation of 2%, although Saint Lucia had price increases of nearly 6%. During the period 1991-1993, inflation had averaged nearly 4% for the OECS countries. Other countries that pursued similar macroeconomic policies were Aruba, despite cost pressures due to a labour shortage, the Bahamas, Barbados and Belize, although the latter was beginning to have problems in the fiscal area.

Trinidad and Tobago fell into a different category; there inflation declined to a little under 9% in 1994 after reaching nearly 11% in 1993 when the exchange rate was deregulated. The monetary based expanded by 24%, MIA by 10.6%, but M2 by only 2.3%.

A third category comprises countries that had inflation rates higher than L0% in 1994, including Guyana with a 16% increase in prices and Jamaica with 35%. While the annual average rate in Jamaica increased, the pace of price

Table V-3

CARIBBEAN COUNTRIES: CONSUMER PRICES

(Average percentage change)

	1990	1991	1992	1953	1994
Anguila	5.1	4.9	2.4	4.3	3.5
Antigua and Barbuda	7.7	2.1	1.2	1.5	3.6
Aruba	7.1	3.7	4.5	6,4	5.0
Bahamas	4.7	7.1	5.7	2.7	1.3
Barbados	3.1	6.3	6.1	1.1	0.1
Belize	3.0	5.6	2.8	1.3	2.3
CUracflo	3.7	4.0	1.5	1.?	
Dominica	4.7	2.0	4.4	1.7	(X9
Grenada	3.7	1.0	4.6	3.5	1.8
Guyana	64.9	70.3	14.2	7.7	16.1
Jamaica	22.0	51.0	77.3	22.1	35.1
Montserrat	6.8	9.2	1.4	0.7	2.8
Saint Kitts and Nevis	3.7	4.5	1.5	1.5	2.7
Saint Lucia	5.9	7.3	2.5	0.7	5.8
Saint Vincent and the Grenadines	9.2	2.3	3.1	4:>	0.3
Suriname	21.8	26.0	43.7	143.4	357.0
Trinidad and Tobago	11.4	3.8	6.5	10.U	8.8

Source: ECLAC, on **the** basis of official figures.

increase slowed over the course of the year, so **that inflation in the** last quarter was only 3%. The **country thus** succeeded in controlling inflation, a **prime goal** of economic policy. The goal was **achieved» however, thanks** to large inflows of **capitel, which stabilized** the exchange rate but **simultaneously** destabilized the monetary **situation, and this** was reflected in high nominal **interest rates. Inflation** control was complicated **by the deregulation** of some prices, including the **price of sugar, by greater** difficulty in covering **the costs of public** utilities **and** by the drought that **affected the supply and** cost of some domestic **products.**

Suriname, finally, remained in severe **disequilibrium,** manifested in particular by **runaway inflation,** which rose to 360% from a **level** of **140% in** 1993. Insufficient control **over monetary and** fiscal policy was the chief **factor in the price** increases. In particular, **central bank financing** of the fiscal and **quasi-fiscal deficit, equal to** 13% of output, **contributed to the increase** in domestic credit. **The quasi-fiscal deficit** was caused by a policy **of multiple exchange** rates, now abandoned. **Controlled interest** rates became increasingly **negative, and** this, combined with a lack of **confidence in** the policies being pursued, **prompted capital** outflows **and a** reduction in net foreign assets and led to a real contraction in broad money.

c) **The external sector**

i) Foreign trade and balance of payments. The trade balance for the region as a whole improved in 1994 on the basis of an 8% increase in exports and a somewhat lower ir crease of 4% in imports. Significant improvements in the merchandise trade account were po¡ ted in Aruba, Belize, Guyana, Jamaica, Suriname and Trinidad and Tobago. The balance of services also improved, chiefly because the major component, earnings from travel, increased by 5%. Altogether, the current account defi< :it contracted 23% from its 1993 level. International reserves increased in a number of countries particularly Aruba, the Bahamas, Barbados, Jamaica and Trinidad and Tobago, but declined in Belize, Guyana and Suriname.

This overall picture, however, obscures contrary developments in the OECS countries, where exports declined nearly L2%, while imports increased 3%, so that the trade deficit widened by over 10%. The weak peiformance of traditional agricultural exports, especially bananas and sugar, reduced export earnings. The trade deficit widened in all the OECS countries,

Table V-4

CARIBBEAN COUNTRIES: BALANCE ON CURRENT ACCOUNT

(Millions of dollars)

	1990	1991	1992	19 ?3	1994
Anguila	-5.8	-7.6	-14.8	-1(1.4	-9.7
Antigua and Barbuda	-37.3	-33.2	-28.2	-21.1	-14.3
Aruba		-235.4	33.9	37.0	69.8
Bahamas	-173Í8	-183.6	-34.1	-97.0	-189.2
Barbados	-16.4	-25.5	144.6	7(1.0	83.6
Belize	15.2	-26.2	-29.1	-49.0	-24.5
Dominica	-31.0	-21.2	-17.5	-1<A2	-26.9
Grenada	-28.0	-34.8	-23.8	-2Ü.3	-16.9
Guyana	-147.8	-118.0	-146.7	-137.9	-100.8
Jamaica	-328.0	-255.8	10.9	-217.2	126.9
Montserrat	-19.3	-15.3	-11.6	-7.4	
Saint Kitts and Nevis	-44.3	-31.7	-12.5	-273	-244
Saint Lucia	-56.7	67.7	46.9	50.2	54.1
Saint Vincent and the Grenadines	-5.5	-23.8	-12.6	-40.9	-47.3
Suriname	25.4	-76.9	18.0	.'i.9	39.8
Trinidad and Tobago	430.0	-20.7	122.6	6".3	369.8

Source: ECLAC, on the basis of official figures.

although to varying degrees; at one extreme was Saint Lucia, where the deficit increased 24%, at the other Grenada, with only a 1% increase, while the other countries fell into the 6% to 10% range. The deterioration in the merchandise trade performance of the OECS countries was not fully compensated by earnings from services, which rose 9% and equalled 20% of output in 1994. Earnings from tourism and remittances by nationals residing abroad were up 8% and 7%, respectively. The current account deficit nevertheless widened by 17%. Capital inflows were up 4% and largely took the form of private direct investment in hotels and telecommunications. International reserves fell by 3% and by the end of 1994 were equal to 2.5 months of imports.

The trade deficit widened in Barbados in 1994 despite good growth in exports of sugar, electronic components and food and beverages, since imports also grew quickly. With the pick-up in the economy, imports of intermediate consumer goods and capital goods increased. The strong performance of tourism, however, which brought in 13% more in earnings, ensured an improvement in the current account, which showed a surplus equal to nearly 6% of GDP, up from 5% in 1993. The capital account also showed a surplus, since government borrowing, which exceeded debt repayments, and private capital inflows were sufficient to finance the hotel construction. Reserves therefore rose to an amount equal to 11 weeks of imparts, compared to seven weeks at the end of 199ÍÍ.

In Belize the balance of payments was strengthened by the good growth in agricultural exports. Citrus, banana and molasses exports all increased and were sufficient to compensate for declines in sugar and marine products. At the same time imports declined, so that the trade deficit narrowed by 25%. This improvement made up for meagre earnings frcm tourism and other services. Transfers remainc d substantially unchanged, with government transfers compensating for reduced private transfers. The capital account surplus achieved in 1993 declined to some extent due to a reduction in long-term official capital, while private inflows contracted only slightly. In consequence, the loss of reserves in 1994 was $4 millio i, in contrast to $19 million in 1993.

In Guyana, export earnings increased, thanks to gold, rice and bauxite, while sugar earnings remained virtually unchanged Imports also increased, but more slowly, so that the trade deficit narrowed by 42% and the current account deficit by 27%, despite a small increase in net outgoing payments for servias. In Guyana, unlike most of the countries in the Caribbean, tourism is relatively unimpcrtant. Capital

Table V-5

CARIBBEAN COUNTRIES: EXTERNAL DEBT

(Millions of dollars)

	1990	1991	1992	19*13	1994
Total	**10 016**	9 **788**	9 **578**	9 4-6	9 **326**
Anguila	7.4	8.4	9.2	86	8.7
Antigua and Barbuda	265.9	261.1	250.6	2358	238.7
Bahamas	267.7	321.7	377.6	3589	328.5
Barbados	418.0	385.5	341.8	337,7	323.3
Belize	132.8	142.8	141.4	167,4	180.4
Dominica	84.7	91.6	93.0	88,9	90.9
Grenada	85.1	84.2	80.9	79,0	81.1
Guyana	1 812.0	1 873.3	2 054.0	2 062.0	2 004.0
Jamaica	4 152.4	3 874.3	3 678.0	3 647.2	3 650.0
Montserrat	3.0	3.4	5.2	10.0	10.3
Saint Kitts and Nevis	37.7	39.1	39.2	40.1	43.9
Saint Lucia	70.7	81.0	97.1	100.9	105.3
Saint Vincent and the Grenadines	56.3	66.1	70.8	77.5	82.0
Suriname	101.3	117.8	124.1	126.3	
Trinidad and Tobago	2 520.5	2 437.9	2 214.7	2 095.8	2 05¿5

Source: ECLAC, on the basis of official figures and information provided by international financial institutions.

inflows, however, dropped drastically with **respect to** 1993, since disbursements to **government** declined by nearly 50% and private **capital** flows by 38%. Since, simultaneously, **debt repayments** increased 42%, the overall balance-of-payments deficit widened by almost **30%;**

The solid performance of merchandise **exports in Jamaica** improved the balance of **payments. The merchandise** deficit contracted by 20% **due to** increases in both traditional and **non-traditional** exports. Among traditional **exports, alumina and** bananas increased by 9%, **while sugar and** bauxite declined. **Non-traditional exports** grew by 17% and **contributed nearly** as much as traditional **products to the growth** of total exports. Imports **fell slightly, chiefly due** to a 6% drop in consumer **goods, while imports** of capital goods declined **marginally and raw material** imports increased. **The balance of** services deteriorated by 12%, **mainly because of** a 5% decline in the travel **account, which** had been growing steadily since 1988. **Private transfers,** chiefly remittances from **nationals living** abroad, increased by 75%, **shifting the current** account from deficit in 1993 **to surplus in 1994.** The capital account showed a **reduced surplus, since** private inflows remained fairly constant while repayments of official debt increased substantially. Overall, international reserves expanded considerably to i he equivalent of 2.5 months of imports. Capital inflows from nationals living abroad were attracled by interest rate differentials, greater confidence in the emerging liberalized foreign exchange market and the availability of better financial instruments.

Export performance was strong in **Trinidad and Tobago.** The trade balance more than doubled, thanks to a strong increase in production and in international prices of methanol. Export earnings from chemicals increased *jy* over 80%, and earnings from fertilizers, natjral gas and manufactures were also up. Imports, on the other hand, declined by 13%, especially imports of machinery and transport equipment, although ores and scrap iron imports for the ¡iteel industry increased and food imports remained stable. The balance of services deteriorated lor all items except travel and freight. The travel account continued to show a deficit, since tourism was a minor component of the economy, but with increased earnings and lower expenditures the deficit contracted. The current account surplus increased five-fold, and this was sufficient to offset the erosion of the capital account, which moved from a small surplus in 1993 to a deficit in 1994. Private capital flows were slightly lower overall, for while direct investment, including the proceeds of privatization, increased, so did outflows of short-term and commercial bank capital. Official capital outflows also increased, primarily to service the debt. The overall balance nevertheless improved by 23%, and reserves increased from the equivalent of 5 weeks of imports to 8 weeks.

In **Aruba,** despite an increase in imports of consumer goods, the trade deficit was reduced by 20% thanks to a 170% increase in earnings from petroleum. This contribution was sufficient to expand the current account surplus, even though earnings from tourism declined 3%, the free zone posted a deficit, and unrequited transfers abroad increased. Repatriated revenues from the petroleum sector surfaced in the capital account, however, causing a large increase in the capital account deficit. Even so, net foreign assets increased by 4%, and non-petroleum coverage of merchandise imports increased from 4.5 to 5.1 months.

ii) External debt. The external debt for the subregion as a whole contracted by 1%, due to declines in the Bahamas, Guyana and Trinidad and Tobago, and only small increases in Barbados, Jamaica and the OECS countries.

Guyana reduced its debt by nearly 3%. The composition of the debt shifted, with a smaller share accounted for by supplier credit and a greater share by official bilateral and multilateral debt. Amortization costs increased by 43%, raising the debt service to exports ratio one percent higher than in 1993. **Trinidad and Tobago** made persistent efforts to reduce its stock of debt and succeeded in bringing it down from 46% to 44% of output. The 2% reduction figure understates what was actually achieved in 1994, because adjustments due to the devaluation of the dollar against other convertible currencies amounted to nearly US$75 million. The currency composition of the debt was ultimately readjusted so that by year end 7D% of the debt was denominated in dollars, 16% in special drawing rights and less than 5% n yen.

The external debt of the DECS members increased 3%, although it déclin îd slightly as a percentage of output. The largest increases were recorded in Saint Kitts and Nevi; (nearly 10%), Saint Vincent and the Grenadines (6%) and Saint Lucia (4%). All other members posted increases of 3% or less. The increase in the debt was due to the accumulation of arrears of principal and interest payments, representing 44% of the total outstanding in 1994. Debt service payments were small and declined by 4% from th i previous year. Repayments equalled 2% of output and were down considerably, both in 1993 and 1994, from the 10% figure for the five preceding years.

There was a marginal increase in external debt in Barbados and Jamaica and an 8% increase in Belize. In **Barbados** external debt represented a little over 24% of output, down from the 28% figure posted since 1990. There was a substantial change in the composition of the debt, however; bilateral debt dropped to less than 3% of the total after the debt owed to the Canadi m Government was pardoned, and multilateral (¡ebt dropped to 39% of the total because of reduced borrowing from international financial inst tutions. Bonds represented nearly 40% of the total debt. In **Jamaica** the increase was in government direct debt, which accounted for 76% of the external debt, compared with 70% in 1993. Both government-guaranteed debt and Bank of Jamaica debt declined and accounted for 11% and 12%, respectively, of total external debt. Some $84 million in debt was rescheduled in 1994, and the Netherlands forgave a total of $8.4 million. In consequence, actual debt repayments in 1994 were 1% lower than the year before. In **Belize,** the debt was equal to 3i% of output, a little lower than in 1993. Disbursements came chiefly from the Caribbean Dev ;lopment Bank (CDB), the International Bank for Reconstruction and Development (IBRD) and the United States.

SECOND PART

COUNTRIES

ARGENTINA

1. General features of recent trends

Economic activity maintained an upward trend in 1994, especially during the first half, so that the level of activity was 7% higher than in the previous year. Cumulative growth since 1990, which stood at approximately 35%, equivalent to an average annual growth rate of 8%, enabled per capita gross domestic product (GDP) to return to the levels attained in the early 1980s, before the debt crisis broke out.

From the point of view of trends in aggregate demand, the increase in investment was especially noteworthy. The capital formation ratio thereby regained a significant portion of the ground lost during the 1980s.

Growth was seen across the board, with manufacturing and mining expanding more slowly than other sectors. However, the unemployment rate continued to worsen, exceeding 12% in October. Meanwhile, inflation remained at very low levels; the variation in the consumer price index (CPi) was less than 4% for the entire year. This trend was associated with the strengthening of behaviour appropriate to a low-inflation regime.

While the surge in domestic spending was curbed during the period, it contributed to widening the trade gap (f.o.b. value), which rose from US$ 2.4 billion to US$ 4.14 billion, in spite of the dynamic growth of exports, especially manufactured goods.

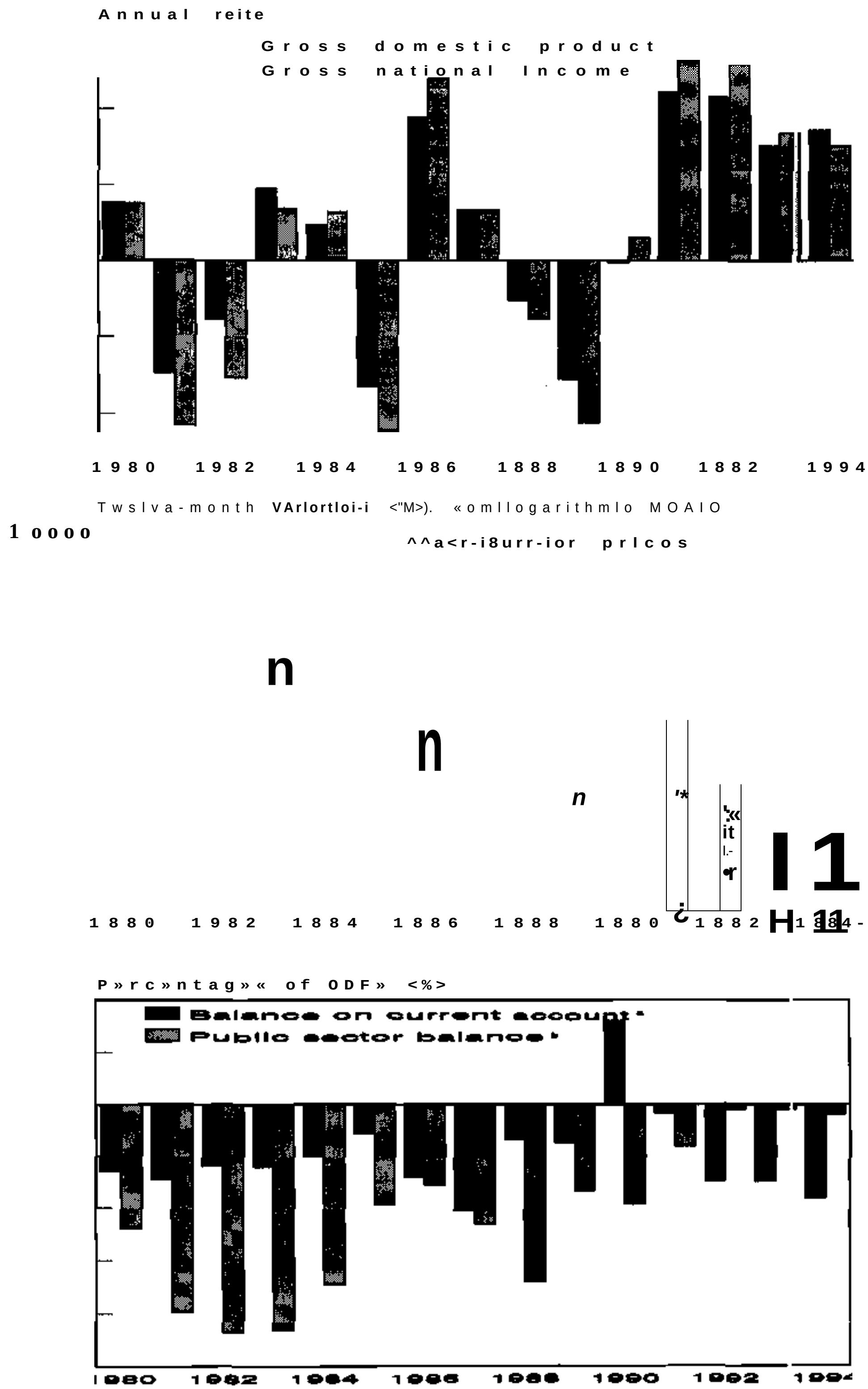
For the period as a whole, the balance-of-paymen deficit on current account increased substantially, to about US$ 10 billion. External financing requirements were covered by major capital inflows. Nevertheless, it became evident, following the rise in interest rates in the United States in February, that international credit terms were less favourable than before.

Economic policy continued to follow the general approach defined earlier. The authorities continued to place emphasis on act ieving a fiscal balance within the narrow constraints which the convertibility plan imposed (in monetary management. However, the cental government posted a small deficit, on a cash-management basis in contrast to the previous y sar's surplus, since expenditure increased whili; income fell. The gap arose in the second hal* of the year, when the public sector posted a c irrent-saving deficit, prompting the authorities to propose spending cuts. In late 1994, the Government decided not to proceed with t tie extended facility agreement signed with the International Monetary Fund (IMF); however, this instrument was renewed a short time later, after its objectives had been reformulated in the light of the new macroeconomic environment.

With respect to foreign trade poicy, the most significant development was the definition of a common tariff structure for the Southern Common Market (MERCOSUR). Sales to Brazil made up a high proportion of total exports, reflecting the region's growing importance to Argentine trade.

The turbulence in capital flows to the region resulting from the devaluation of the Mexican peso in December 1994 hid intense repercussions, including a drop in the demand for Argentine securities. At first, the behaviour of those holding such securities appeared to reflect a clouding of country exposure perceptions and uncertainty as to the viability of the fixed exchange-rate system. Nevertheless, the signals given by the Government enhanced the widespread feeling that any change in the par value of the currency could spark mayor upheavals, given Argentina's experience with inflation and the growing use of the dollar as the currency in

Figure 1
ARGENTINA: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.
a Of the balance of payments. b National non-financial public sector, excluding the provinces and municipalities.

which contracts were denominated. Thus, it became clear that the economy would adapt to the new external financing conditions by maintaining the fixed exchange-rate system then in force.

In the early months of 1995, the financial system came under strong pressure. While deposits shifted to the institutions perceived to be more solid, the total volume of deposits, in both dollars and local currency, contracted sharply. The reluctance to keep funds in the banks was associated with an increase in deliberate currency holdings, which was exacerbated by a seasonal low in the demand for money. Furthermore, the Central Bank was obliged to expand domestic credit as a result of its support for struggling financial institutions. Against this backdrop, international reserves diminished, and the degree to which the monetary base was backed by foreign exchange decreased, while remaining within the limits set by the convertibility system.

In early March 1995, securities prices plunged further, while the drop in deposits aroused fears of a run on the banks. One factor contributing to this climate was probably uncertainty as to the fiscal situation, given the decline in tax revenues. The authorities then decided on Draconian adjustment measures, including nominal cuts in highest government salaries and a tax increase, a notable feature of which was a 3% rise in the value-added tax (VAT), Similarly, an agreement with IMF was announced and loans were negotiated with other multilateral institutions. The resources obtained from these sources and from a loan agreement signed by large Argentine firms with foreign banks enabled the Government to build up a stock of funds with which to make payments on its debt and assist in the restructuring of the banking system. Furthermore, the Central Bank's charter was amended in order to enable it to act with greater flexibility as a lender of last resort, and a new bank deposit insurance system was announced.

These announcements had an impact on the demand for securities and stocks. The change of attitude in the markets for those instruments reflected a more favourable mood among investors, including, obviously, :hose in other countries. This led to a clear rebcund in prices, which offset a substantial portion of the drop that had occurred since mid-December. The response with respect to the demand for deposits was less clear, althougt the risk of a massive withdrawal lessened. The easing of tensions in the financial system became more apparent after the elections in mid-May, in which the President was voted back into office, and solid congressional backing for his administration was expressed. Ii subsequent weeks, the volume of bank depos its recovered substantially.

Be that as it may, the volatility ill the financial markets persisted. It remained to be seen how the restructuring of the financial syste m, which had begun with a number of operations involving transfers of ownership and several 1 »ank closings, would proceed. Moreover, while there had been signs in late May of a possible relaxation in the supply of credit, restrictive financhg conditions persisted. A large number of firms, especially smaller ones, continued to face severely limited access to credit, and such loans is they could raise were financed at significantly high interest rates.

This appeared to give rise to a considerable change in the pattern of demi nd and the incentives for various types of activities. In early 1995, consumption apparently contracted, while exports surged strongly, which led to a turnaround in the trade gap. This was partly in response to external stimuli, such as the strengthening of Brazilian demand, but it also demonstrated the flexibility of supply geared to the external market, which helped to sustain production in various sectors. At the same time, a range of activities were affected by the slump in the local market, which led to fairly dissimilar trends in manufacturing. Overall output in this sector rose during the first quarter, a noteworthy achievement in the light of the turbulence the financial markets. Nevertheless, it ¡ eemed clear that the effects of slack domestic demand would be felt over the next few months. In that context, the interaction between the level of economic activity, the development of fiscal policy and the behaviour of the financial markets proved to be a decisive factor.

Table 1

ARGENTINA: MAIN ECONOMIC INDICATORS

	1987	1988	1989	1990	1991	1992	1993	1994'
				Growth rates				
Growth and investment								
Gross domestic product	**2.7**	**-2.1**	**-6.2**	**-0.1**	**8.9**	**8.7**	**6.0**	**6.9**
Per capita gross domestic product	**1.2**	**-3.5**	**-7.5**	**-1.4**	**7.5**	**7.3**	**4.8**	**5.6**
Gross national income	**2.7**	**-3.1**	**-8.5**	**1.2**	**10.5**	**10.4**	**6.7**	**6.1**
Gross domestic product by sector								
Goods	**3.0**	**-2.0**	**-9.9**	**1.4**	**10.8**	**7.8**	**4.5**	**5.4**
Basic services	**4.1**	**-2.5**	**0.6**	**-0.5**	**3.7**	**9.4**	**8.1**	**6.9**
Other services	**1.5**	**-2.0**	**-3.6**	**-0.1**	**7.0**	**7.2**	**7.2**	**7.9**
				Percentage:s				
Contribution to growth of GDP [c]								
Consumption	**1.1**	**-4.3**	**-4.0**	**-1.6**	9.7	8.3	4.2	3.2
Gross fixed investment	**2.2**	**-0.6**	**-3.9**	**-1.5**	3.4	4.8	2.5	3.8
Exports	**•0.2**	**2.2**	**0.7**	**3.0**	-1.3	-0.1	0.7	2.1
Imports	**•0.4**	**0.7**	**1.1**		-2.9	-4.3	-1.4	-2.2
				Percentages of GDP				
Gross fixed investment	18.1	17.9	14.9	13.4	15.4	18.6	19.9	22.1
National saving	14.9	16.7	13.9	16.6	15.0	14.9	16.0	17.2
External saving	3.2	1.1	0.9	-3.2	0.4	3.7	3.9	4.9
				Percentages				
Employment and wages								
Activity rate [e]	40.5	40.5	41.4	40.5	40.9	41.6	43.8	43.3
Open unemployment rate	6.9	6.3	7.6	7.4	6.5	7.0	9.6	11.5
Real minimum wage (Index: 1990=100)	565.8	442.2	323.5	100.0	259.1	203.7	263.7	363.9
				Growth rates				
Prices (December to December)								
Consumer prices	174.8	387.7	4 923.8	1 343.9	84.0	17.5	7.4	3.9
Wholesale prices	181.6	431.6	5 386.4	798.4	56.7	3.2	0.1	5.8
External sector								
Terms of trade (Index: 1990=100)	99.5	104.3	97.6	100.0	99.3	102.2	104.8	105.2
Nominal exchange rate (pesos per dollar) [g]	0.0002	0.0009	0.0290	0.4150	0.9171	1.00	1.04	1.04
Real effective exchange rate (Index: 1990=100)	122.4	129.7	143.1	100.0	83.3	77.5	74.0	78.0
				Millions of dollars				
Balance of payments								
Current account	-4 235	-1572	-1305	4 552	-647	-6 546	-7 363	-10 070
Balance of trade in goods and services	511	3 837	5 505	8 359	3 236	-3 448	-4 729	-6 535
Exports	8 140	11 143	11759	14 796	14 382	14 794	15 766	18 575
Imports	7 629	7 306	6 254	6 437	11 146	18 242	20 495	25 110
Capital account	2 319	3 430	-43	-1173	3 276	11095	9 911	10 694
International reserves (variation)	-2 213	1921	-1322	3 092	1 978	4 250	2 596	503
				Percentages				
External debt								
Gross debt (as percentage of GDP)	56.4	50.0	70.3	42.7	34.0	29.2	27.2	27.6
Net interest (on exports)	48.2	40.1	49.0	25.4	24.0	19.0	13.1	13.2

Table 1 (conclusion)

	1987	1988	1989	1990	1991	1992	1993	1994[a]
	Percentages of GDP							
Non-financial public sector								
Current income '	14.8	13.3	12.1	13.2	15.0	17.4	19.9	17.9
Current expenditure	15.8	16.1	13.3	15.4	16.2	16.8	18.8	17.2
Saving	-1.0	-2.8	-1.2	-2.2	-1.2	0.6	1.1	0.7
Capital expenditure	3.6	4.0	2.1	1.6	0.4	0.7	1.2	1.1
Financial balance	-4.6	-6.8	-3.3	-3.8	-1.6	-0.1	-0.1	-0.4
	Growth rates							
Money and credit								
Banking system monetary balance								
Net domestic credit	263.3	273.8	8 013.1	230.5	151.9	15.0	32.0	
To the public sector	314.1	293.1	14 888.4	220.1	55.9	-21.6	14.2	
To the private sector	201.2	354.3	5 607.7	734.5	112.0	53.5	23.7	
Money (Ml)	124.4	337.6	4102.8	1 070.8	144.4	51.5	34.0	12J
Savings and time deposits in local currency	129.1	483.7	213.7	4 719.3	64.9	73.9	47.5	11.0
M2	165.0	442.2	1 105.0	1 802.9	104.0	60.7	40.0	11.9
Dollar deposits				473.1	269.3	64.6	60.7	24.4
	Annual rates							
Real interest rates (annualized)								
On deposits				-25.2	-10.4	-3.8	3.4	4.3
On loans				81.9	43.6	12.5	14.3	17.2
Equivalent interest rate in foreign currency[J]				138.0	-8.8	13.1	10.1	8.2

Sourcei BCLAC, On **the** basis of official figures.
[a] **Preliminary** figures. Based on 1980 dollars at constant prices. [c] Measures the impact ofthe variation <f each aggregate on **the** growth of ODP. Derived by multiplying the annual rate of variation of an aggregate by the ratio of that a ggregate to GDP. **Includes** variation in stocks. [e] Percentages of the working-age population. Percentages of the economically active **population.** * Corresponds to the exchange rate for exports. Refers to the net balance-of-payments interest on exports of goods **and** services. 'Includes the central government, the national social security system and public e iterprises, based **on final budget** figures. [J] Interest rate on deposits deflated by the variation in the exchange rate.

Table 2

ARGENTINA: MAIN QUARTERLY INDICATORS

	1992				1993				1994[a]			
	I	II	III	IV		II	III	IV		II	III	IV
Consumer prices (12-month variation, %)	30.1	19.6	17.9	17.5	12.1	12.3	8.9	7.4	5.1	3.0	3.7	3.9
Real effective exchange rate (Index: 195*0*100)[b]	79.1	77.5	77.7	75.7	75.1	74.5	73.3	73.1	73.4	75.4	80.3	82.9
Real interest rate (annualized, %)												
On deposits	-15.3	**-0.8**	**-6.1**	7.0	**4.5**	**-2.0**	5.3	5.7	**6.0**	3.9	**1.2**	**6.1**
On loans	3.1	20.3	9.9	16.6	14.9	**8.7**	15.8	17.7	19.9	16.6	12.6	19.9

Source: ECLAC, **on the** basis of official figures.
Preliminary figures. Refers to the exchange rate for exports.

2. Economic policy

The convertibility system introduced in 1991 severely restricted monetary policy, thus also placing strict limits on fiscal management. One of the priorities of economic management in the following years was to reach and maintain equilibrium in public finances. The rapid increase in receipts from broad-based taxes (particularly the VAT) played a crucial role in reducing the fiscal deficit and enabled policies to be more focused on the allocative effects of taxation. Thus, a variety of minor taxes were reduced or eliminated and employer contributions to the social security system were lowered, as a means of reducing the costs of activities exposed to foreign competition.

The overall balance of the public sector was once again at the centre of attention in 1994, as the impact of the social security cuts and the pension scheme reform began to be felt. Meanwhile, VAT receipts increased more slowly. Overall, central government tax revenues increased by a much smaller amount than in earlier periods, while outlays continued to expand. This meant a significant decrease in the primary surplus, which was reflected in a small overall deficit, prompting the authorities to propose spending cuts.

With respect to foreign trade policy, the launching of the MERCOSUR customs union was especially noteworthy. Customs tariffs were abolished in intraregional trade, except in respect of a list of products that are to receive special treatment during a transitional period (four years for Argentina and Brazil). At the same time, the structure of the common external tariff (14% on average) was defined. As regards capital goods, the main topic of discussion, an agreement was reached on a convergence towards the common tariff over a six-year period, in the case of conventional machinery; the period would be 11 years in the case of computer and telecommunications products.

a) **Fiscal policy**

After two years of surpluses, the national non-financial public sector posted a cash-management deficit in 1954, totalling 84 million pesos. The primary surplus, excluding privatizations, decreased frcm 5.1 billion pesos to 2.3 billion pesos, or the equivalent of 0.8% of GDP. These figures reflected quite different trends between the f rst and second halves of the year; thus, a small primary deficit was recorded in the second half of 1994, as compared with a considerable surplus in the first half.

The fiscal performance in 1994 was characterized by an expans on of current expenditure, which rose from 16% to 17% of GDP, and by slower growth of current income, which remained at around 17% of GDP. On the expenditure side, the constant increase in social security benefits, whict accounted for more than half of the increase n total primary expenditure, stood out. One factor influencing this trend was the transfer of the social security funds from some local jurisdictions to the central government, but the main impetus stemmed from higher payments under the existing scheme. On the incorr e side, the cuts in employer contributions and the pension scheme reform implemented in the second half of the year led to a declin; in resources estimated at 2.1 billion pesos for the period; this was partially offset by the revenues obtained from refinancing >ocial-security debts, VAT receipts were affected by the substantial increase in tax reba es to exporters. At any rate, in the second half of the year there was only a slight nominal increase in gross (i.e., pre-rebate) VAT receipts as compared with the same period in the previous year. On the other hand, the rapid increase in revenues from the profits tax, to which c langes aimed at expanding the tax base, had been introduced, continued.

After prolonged discussion, a new pension scheme came into force in 1994. Active workers could choose between joining the new capitalization system, by transferring their personal contributions to the recently created private pension funds, or remaining in the existing public-sector system. The number of people opting for the capitalization system was on the rise, reaching 3.5 million by late 1994.

The number of privatizations was not as high as in 1993, when equity shares in the Yacimientos Petrolíferos Fiscales (YPF) oil company were sold. Nevertheless, the Government raised about US$ 700 million from privatizations in 1994 especially from the transfer of natural gas exploration and transport. In addition, the central government carried out various financing operations during the year. Gross sales of debt paper exceeded US$ 5 billion; Eurobonds, totalling US$ 2.6 billion, accounted for the bulk of the issues. Loans were also raised from foreign banks and multilateral lending agencies.

b) Monetary policy and the financial markets

Monetary aggregates grew more slowly. The monetary base expanded by slightly more than *1%*, down from 36% in 1993. Intervention in the foreign-exchange market during 1994 had a slightly expansionary net monetary effect. Government securities purchase and buyback operations between the Central Bank and financial institutions reached a higher volume than in previous years, thus also contributing to an increase in the monetary base, especially in the second half of the year. Notwithstanding the higher volume of domestic credit transactions by the Central Bank, its gold and foreign exchange reserves made up 98% of the monetary base at the close of 1994, and were thus well in excess of the minimum levels required by the convertibility system.

The slower pace of primary money creation in 1994 was linked to a downturn in the demand for liquid assets in local currency. Thus, the rate of growth of the means of payment (Ml) slowed to 13%, down from 34% in 1993. For the year as a whole, a rise in the liquidity coefficient was seen, so that the MI/GDP ratio increased to 4.8%. However, the increase was smaller than in previous years, suggesting a virtual exhaustion of the remonetization process. Meanwhile, the volume of private interest bearing deposits in local currency rose considerably faster than price levels, but more slowly than in previous years. At the same time, bank deposits in dollars expanded more rapidly than those in local currency; dollar term deposits, in particular, swelled by almost one third. Total deposits in the financial system, of which dollars constituted more than half by the end of 1994, rose 19%. The volume of bank loans also expanded, although by a smaler ratio than deposits; the reduction in the amount of loans to the public sector made it possible to increase private-sector financing by almost 20%. A higher proportion of bank lending operations were in dollars as well.

Trends in the financial markets were influenced by international developments. The gradual rise in United States interest rates from February onward had far-reaching effects. The prices of Argentine securities reacted disproportionately to the drop in United States bond prices. Furthermore, the volatility of these prices increased. Stock prices also showed greater instability, falling from the highs reached in February.

While these adjustments in securities prices suggested a change in the structure of external financing, they did not have a strong impact on the lending markets. The prices of stocks and bonds remained above the mid-1993 levels. In the second half of 1994, before the crisis in December, prices fluctuated without showing a downward trend, and bank interest rates rose, although only moderately. In any event, the lending markets continued to display marked segmentation, in the form of vast differentials in interest rates and credit availability for various categories of operations and borrowers.

The Central Bank implemented a variety of measures linked to the prudential management of the system. In 1993 a minimum capital requirement for banks, of 8.5% of financing operations had been established; this percentage had risen to reach 11.5% in early 1995. The capital requirement ratio varied in accordance with the banks' portfolio risk assessment. In 1994, rules were adopted for rating debtors in accordance with their ability to pay, based on a flow-of-funds estimate, and for establishing reserves for bad debts.

3. Trends in the main variables

a) Economic activity

The 7% expansion in GDP in 1994 prolonged the rapid-growth phase that had begun in 1991. Domestic demand again increased faster than output. The acceleration in domestic spending was due primarily to the buoyancy of investment, which rose by somewhat more than 18% in 1994, with a cumulative growth of 120% over the four-year period. Consequently, the investment ratio continued to rise, reaching 22% in 1980 dollars, which was close to the levels reached before the 1980s crisis.

The strengthening of capital formation in 1994 was due to the same stimuli as in the recent past. Residential construction was bolstered by the same increase in total income and by the continuing expansion of mortgage loans, which had facilitated housing purchases after a prolonged "dry spell" in private home finance. Meanwhile, the substantial rise in the incorporation of imported machinery and equipment meant a significant increase in total investment in this category, despite the drop in domestic production of machinery. The low relative prices of equipment and the financing offered by foreign suppliers continued to stimulate purchases of such goods. In manufacturing, current or planned investments were concentrated in the production of food and other items of mass consumption, the iron and steel industry, and automobile manufacturing; the prospects offered by foreign markets, especially Brazil, played a role in several projects. In addition, the incentives which firms received for modernizing their plants, with a view to improving performance in a competitive environment, continued to have an impact on the entire sector. At any rate, even though the value of imported industrial machinery rose, its share of the country's total imports sank to slightly less than one third. In contrast, a larger share went to services; transport, telecommunications and the electrical and financial sectors all continued to absorb large volumes of imported equipment.

The growth rate of total consumption in 1994 was similar to what it had been in the preceding year, and was thus substantially lower than the rate seen in 1991-1992. This revealed a slowdown in household expenditure, which had expanded rapidly during the initial phases of the convertibility programme, with an elastic response to rising incomes and the renewed availability of credit. The 1994 fij jures confirmed that the domestic savings ratio had recovered, following a period of distinct declines. Nevertheless, the generation of domestic savings lagged substantially behind the resources allocated to capital accumulation, as shown by the foreign trade balance.

The physical trade balance for goods and services continued to deteriorate The volume of imports continued to expand rapidly (20%), resulting in a cumulative rise of 265% over the low 1990 levels. A notable feature of import trends in 1994 was the surge in purchases of machinery and equipment. Meanwhile, export volumes registered significant growth (approximately 15%).

For the third year in a row, goods-producing sectors expanded more slowly tlian total output in 1994. However, their growtli rate exceeded that of the previous year, owing :o the improved performance of agriculture and construction, as well as the significant increases in mining production. While the boom in the basic services sectors slowed somewhat, othei services again showed strong growth, especially because of the higher volume of financial and commercial transactions, which largely reflected the increased flow of goods. While the registered output of community and personal services increased more slowly than in 1993, their growth far outpaced the natural population increase. As a result, the "other services" category accounted for more than 55% of total GD]' growth, while goods-producing sectors contributed somewhat less than one third.

Agricultural production rose **t** y just under 2% to recover from the previous year's drop. The grain harvest for 1993-1994 ros; by almost 5% as a result of a small increase in the sown area and, above all, improved yiells. Among the notable results were the increase in soya production, which returned to the level of 11.3

million tons achieved during the 1991-1992 growing season, and the solid expansion of the sunflower harvest by 30%, reach 3.9 million tons. These two factors account for the growth in oilseed grains. In contrast, the cereals harvest declined somewhat, reflecting lower wheat and sorghum production; maize output rose to just over 10 million tons. A major increase in total grain production was forecast for the 1994-1995 season, with abundant wheat, maize, soya and sunflower crops.

Cattle-slaughtering dropped slightly to just under 12 million head. The average slaughtering weight fell, while the percentage of cows slaughtered increased, but not to the point of endangering stocks. Nominal cattle prices declined, which meant a relative disadvantage with respect to the prices of industrial goods and major grains, such as wheat. While the volume of exports swelled, it did not return to the levels of the early 1990s. The share of meat production for foreign markets (11% in 1993) increased to 14%. Foot-and-mouth disease was brought under control, a notable development which creates new marketing opportunities for Argentine meat products.

The upward trend in oil and natural gas drilling contributed significantly to increase mining production. Furthermore, during 1994, large-scale production projects were announced for metallic minerals, including copper and precious metals.

The rate of GDP growth in manufacturing, slightly more than 4%, was lower than in previous years. Seasonally adjusted data suggest that the level of activity was lower in the second half of the year than in the first. Nevertheless, there were no signs of a clear break in the expansionary phase. On the whole, the domestic demand for industrial products appears to have fluctuated without showing any clear trend; however, the flow of exports increased.

While the growth of the motor vehicle industry again exceeded the average for the manufacturing sector; the rate of increase in the number of units manufactured (19%) did not equal the exceptional records of the previous three years. Meanwhile, the production of certain household appliances fell precipitously, while remaining at levels well above where it had been prior to the recent sharp upturn. In general the rate of output of consumer durables slowed, but remained high.

In contrast, activity rose steeply in a number of major intermediate goods sectsrs. In several cases, this marked a recovery frcm the decline brought on by foreign competition In addition to the impact of productivity gains and steady local demand, this trend appeared to partially reflect improved international prices; at lhe same time, the use of trade weapons (countervailing measures against unfair competition, specific duties and quotas, as appropriate) reduced the competition from imports in some sectors.

The food industries, encompassing a wide range of products, recorded siz sable growth (around 6%). Output also grew in construction-related industries. At the same time, there was a significant rise in the production of transport equipment for investment purposes, given the constant increase in automobile production and the surge in tractor production. On tie other hand, the information available indie; ites that the manufacture of machinery declined substantially.

During 1994, major transfers of ownership or control of industrial firms took pli ce, which, in several instances, meant that fsreign firms entered the market or expanded. Such operations involved the food, consumer chemical products and paper industries, in particular.

b) Prices, wages and employment

The increase in the consumer pri:e index (CPi) for 1994 as a whole was less than 4%, the lowest in the past four decades. There was 1 ittle variation in the relative prices of the various spending components. Of particular ncte was the decreased inflation in the prices of private services (from nearly 11% in 19! >3 to 5% in 1994), which was thus barely higher than the general price increase. The infla ion in food prices also slowed to less than 2% for the year, with lower nominal prices for major items, such as fresh meat and fruits, vegetables and pulses. Clothing prices declined again, this time by 2%, for an overall drop of 5% in the most recent two-year period.

For the first time in five years, the wholesale price index rose at a faster pace than the consumer price index. The diffère ice was not great, but it meant a reversal of traditional trends. The increase of almost 6% in the wholesale price index during 1994, as compared with the stability seen in 1993 and the rise of only 3% in 1992, reflected mainly higher international prices. These price rises were reflected directly in the imports component of the index, which jumped more than 19%, and indirectly in the prices of locally produced agricultural and manufactured goods.

During 1994, nominal wage increases in manufacturing kept pace with the CPI. This meant that real wages remained at far higher levels than during the hyperinflationary periods, although without returning to the levels characteristic of the previous decade. Because of the growing misalignment of relative prices in previous years, industrial wages in 1994 remained high as compared with the prices of manufactured goods. The effect on costs was mitigated by the productivity gains achieved in numerous activities and by reduced social security contributions.

The recent economic upswing has been characterized by worsening unemployment, which has been rising steadily since the end of 1991. This trend intensified in 1994, when for the first time in the series, the open unemployment rate in several large urban areas exceeded 10% in the May survey and 12% in the October one. The increase in unemployment between October 1993 and October 1994 was almost 3%, and it had a major impact in Greater Buenos Aires. The unemployment rate declined in only three of the 25 areas in which the survey is conducted, and these had smaller populations. This proves that the worsening of unemployment is geographically widespread. Furthermore, the data for Greater Buenos Aires show substantial increases in the unemployment rate for all categories of workers, whether classified by sex or by age.

In contrast to the situation up until mid-1993, the labour force participation ratio declined in 1994, while remaining at record high levels. There was also a drop in the employment ratio, which measures the ratio of employed workers to the total population. For the 25 large urban areas, this ratio fell to 35.8% in October 1994, as compared with 37.1% in October 1993 and 37.4% in May 1993. This trend suggests that the number of jobs declined, in spit i of the marked increase in GDP.

During 1994 public discussion c întred on various changes to the labour code whicli were designed to streamline hiring procedures, especially for small-scale enterprises and young workers. Moreover, an unemployment jenefit scheme remained in force, and provided assistance to some of the workers affected by lay-offs.

c) The external sector

Although the rise in United States interest rates had an impact on the financial resources available to Argentina, the inflow of resources from abroad remained at very hi jh levels during 1994. A small portion of the financing -much smaller than in previous years- was allocated to the build-up of reserves, since the demand for money was increasing even more slowly. The funds were intended mainly to cover the substantial current-account deficit.

During the second half of the year there were signs that the current-accou it deficit was beginning to decrease. Nevertheless, the figures for the whole year showed a wid îning of the gap seen in previous years to over US$ 10 billion, which is equivalent to about two thirds of merchandise exports. The increí se in the deficit over the already high 1993 le\el reflected the trends in merchandise transactions, whose deficit (f.o.b) increased to US$ 4.14 billion. This was partially offset by a small reduction in the real services deficit. The rise in international interest rates had an impact on the respective account balance; similarly, the flow of profits and dividends was higher. Accordingly, the financial services deficit rose by some US $ 700 million to

Argentina's balance-of-payments accounts are being revised with respect to financial transactions. The doubts arise mainly from the calculation of resident and non-resident asset holdings and the income flows associated with them. ' rhe comments in the text are based on estimates obtained with the traditional methodology, which extend the series prepared by t le Central Bank. An alternative calculation method exists which allocates a larger amount to residents interest earnings, resultini; in a lower estimate of the current-account deficit. In any event, such differences have a greater impact on the level of the variable I ban on its short-term trends.

US$ 3.85 billion, which was similar to the 1992 amount and lower than the 1991 figure.

Capital flows remained in the US$ 10 billion range, so that the net transfer of resources abroad -i.e., the external financing in excess of the financial services deficit- contracted slightly, but still hovered around the US$ 7 billion mark. The structure of external financing had specific characteristics in 1994. Income from privatizations fell markedly, to some US$ 600 million. Although direct investment increased, its size as recorded in the balance of payments remained below US$ 700 million. Income from the sale of private bonds dropped in net terms to US$ 1.45 billion, or 14% of total net receipts. Thus, the maintenance of external credit flows was associated with the significant rise in other private capital flows, totalling US$ 6.1 billion, which represented well over half of total net financing. One factor contributing to this trend was the expansion of trade credit derived from the increase in imports, especially of machinery and equipment.

The foreign trade deficit was 58% higher than the 1993 figure, which had already set a record. Nevertheless, if seasonal factors are discounted, the deficit had clearly fallen by late 1994 from its massive levels at the beginning of the year; this trend was attributable chiefly to the surge in exports, especially in the fourth quarter.

Merchandise exports were up 20% over the previous year, owing to higher sales volume for the leading export categories, since market prices improved by barely 2% on average. Among primary products, there was sizeable growth in exports of all animal products (meat, hides and wool), as well as oilseeds and oils and other agricultural products. Notable increases were seen in the volume of exports of soya beans (almost 39%), sunflower oil (more than 49%), and soya oil (23%). In contrast, exports of cereals contracted owing to lower shipments of maize and sorghum, which were only partially offset by the increase in wheat exports, although sales did not reach the volumes recorded prior to the 1993 drop, Fish exports were virtually stagnant following a peak period.

The growth rate of non-agricultural exports accelerated to almost 27%, thereby raising the share of total sales of such goods to nearly 43%. Sales of fuels spurred mainly by higher crude oil exports, again showed rapid growth (32%), reaching a level more than double that of three years earlier. Foreign sales of road vehicles also continued to show strong growth (38%), bolstered by growing Brazilian d« mand, as well as the special regime applied to tie automotive sector, which enables firms to impart products at low tariff rates if they agree to export the end product. The value of exports reached a record level owing to the growth of nearly 23% in other non-traditional products. Various categories of goods shared in the 1994 growth, including machinery and electrical equipment, metal manufactures, chemical products s nd textiles.

Exports to the MERCOSUR countries rose 28%, or more than the total, accounting for more than 30% of total exports. The share ≫f MERCOSUR exports was even higher (34%) in tlie second half of the year, a trend which underline s the growing importance to Argentine trade of 1 he demand in neighbouring countries. Argentine trade with the MERCOSUR countries showed a surplus in the second half of the year, in contrasl to the earlier situation. Meanwhile, imports fron MERCOSUR countries increased somewhat less than the total; their share was just under 24%, with similar percentages in both halves of the year.

The value of merchandise impôts (ci.f.) was 28% higher than in the preceding year, reaching US$ 21.5 billion. Thus, import growth accelerated, taking into account tlie figures for the year as a whole. However, the pi ice of imports tended to slacken as the year progressed; if seasonal factors are discounted, inport values were lower in the second half of 19 *H* than in the first six months.

The increase in imports in 1994 affected all categories of goods classified ty economic purpose, but the higher volume of capital goods was especially noteworthy. The value of equipment purchases grew by nearly 50%, representing more than a tenfold increase over «heir 1990 level, and their share of the total rose to 28%. Similarly, imports of cons umer goods, which had slowed in the previous year, showed renewed vigour, reaching some US $ 5.3 billion. The increase of nearly 18% in imports of intermediate goods, while less steîp, was also striking.

BOLÍVIA

1. General feat» of recent trends

In 1994 the Bolivian economy grew by over 4% for the second consecutive year, while inflation continued on a downward trend, falling to an 8.5% annual rate, its lowest level in 18 years. At the same time, Bolivia managed to reduce its fiscal and trade deficits. These achievements are signs of further progress towards the attainment of macroeconomic equilibria and a sustained economic recovery; however, per capita gross domestic product (GDP) is still 13% below the level reached in 1980.

Export growth was a key factor in this panorama, as domestic demand fell. Indeed, the notable improvement in exports (which grew by almost one fifth, bolstered by a rapid expansion of non-traditional products) was the main factor driving overall demand, and accounts for a demand increase equal to more than 6% of the previous year's GDP. However, the bulk of this contribution was counteracted by a sizeable decrease in fixed capital formation and in inventories.

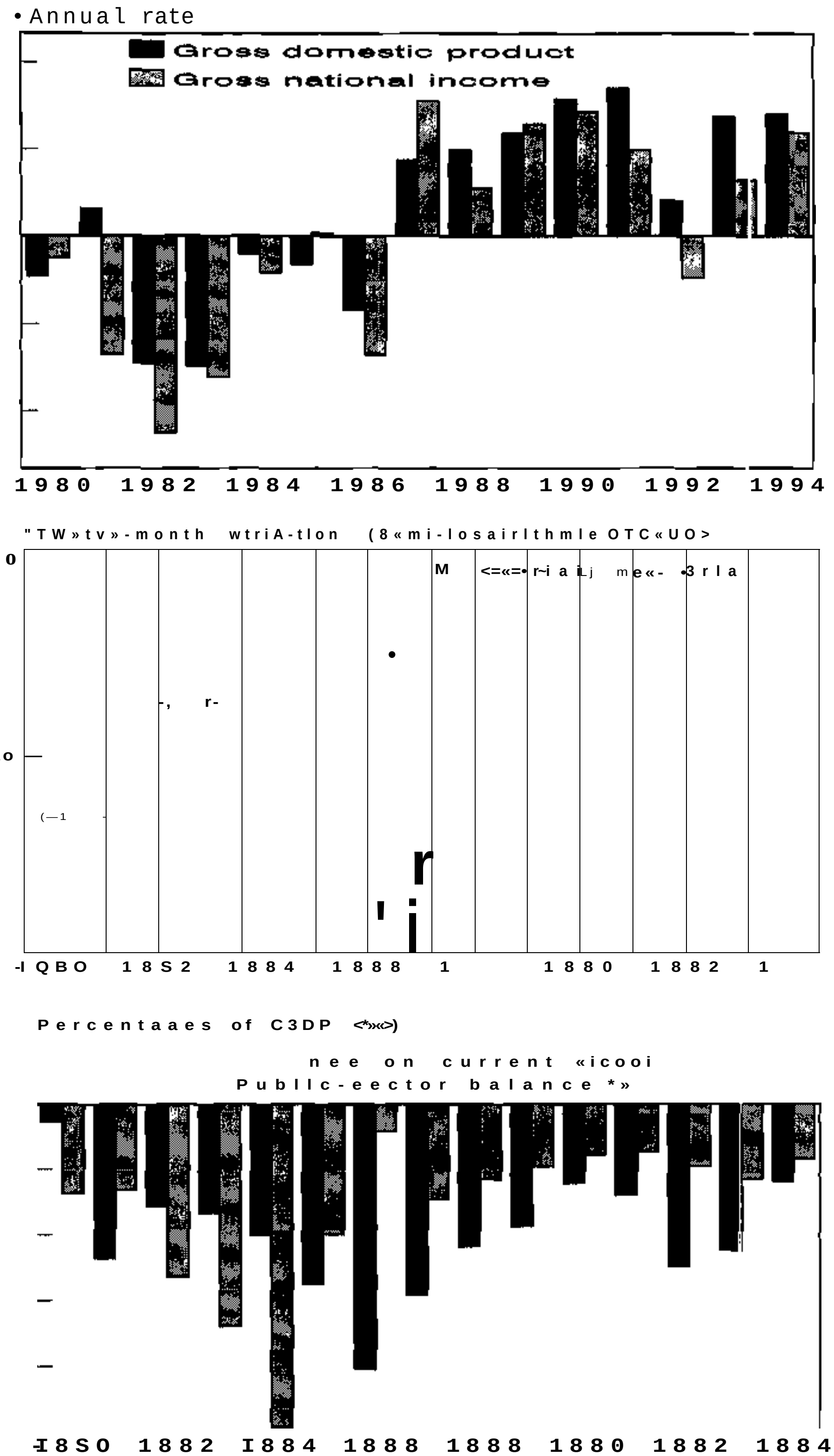
Given the virtual stagnation of imports, the increase in exports significantly reduced the balance-of-payments deficit on current account, which, combined with new foreign capital flows, made it possible to increase international reserves. These external resources were more than sufficient to finance a small non-financial public-sector deficit (-4.2% of GDP), which made it possible to reduce domestic borrowing.

The abundance of foreign exchange contributed to a comfortable management of the foreign exchange market such that, during the year, dollar values fell at an annual rate of almost 7%. Given the high dollarization of the Bolivian ecoromy, and the role that the exchange rate plays in domestic price formation, this trend made an essential contribution to the new, if slight, slowdown in inflation.

The contractionary behaviour of net credit to the public-sector provided support for monetary policy. During the first 10 months of 1994, the main factor in the growth of the money supply had been the purchase of international reserves. However, the financial assistance which the Central Bank of Bolivia had to provide, beginning in November, to two banking institutions closed by the Bank Supervisory Authority substantially increased the money stock towards the end of the year. The Central Bank somewhat aleviated the problem of refunding deposits to the public through the use of term instruments, which partially postponed the expansion to the following year. At any rate, this move changed the framework of monetary policy for the succeeding months.

Against this background, the <arly months of 1995 were marked by a fresh surge of inflation, which reached a 12-nnnth rate of somewhat over 10% by mid-year. While the programme adopted early in tie year had forecast a higher growth rate, the rate slowed to under 4% per year during the lïrst quarter. The shift in trends also affected the external sector, with a significant increase in imports stemming largely from the faster pi ice of public investment, while exports declined after the rapid growth achieved in the previous year. The privatization programme began in the first half of the year with the sale of three electricity-generating enterprises, which netted US$ 140 million.

Figure 1
BOLIVIA: MAIN ECONOMIC INDICATORS



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2. Ecor lie policy

Stabilization continued to be **the** chief goal of **economic policy** almost 10 years after the **outbreak of hyperinflation. In** a context of trade **liberalization, strategy** continued to be based on **the generation of** current-account saving by the **public Sector, the** restriction of capital **expenditure to the** domestic and external **resources available, and** a crawling-peg **exchange-rate system** adjusted to the inflation **target. Thus, the** authorities have adopted a **mainly passive approach to** monetary policy, **taking steps to keep** money creation within the **bounds set by the inflation** target.

During 1994, for the first time since the **adoption of the macroeconomic** stabilization and **structural adjustment programme in** 1985, the **country managed also to** reduce the high degree **of dollarization** of **the** economy that had been **generated during the** hyperinflationary periods in **the mid-1980s. In this** connection, steps were **taken to eliminate** the marginal reserve **requirement on** deposits in local currency, **abolish the offsetting** of currencies (local and **foreign) in the setting up** of reserves and raise the **ceiling on the foreign** exchange position of the **financial system.**

The method of determining the exchange rate **was changed. After the middle** of the year, **in** an **effort to keep the real** exchange rate from falling, **the reference value** ceased to be paired **with** the **United States dollar, and** was based on a basket **of currencies.**

a) Fiscal policy

The main objective of fiscal policy has been **to achieve a current-saving** surplus. In 1994, **fiscal policy was also** geared **to** reducing the **non-financial public-sector** deficit, which **continued to be more than** amply financed from **external resources.**

The overall deficit, which had increased to **levels approaching 6% of** GDP in 1993, fell to **slightly over 4%** of GDP in 1994. With this result, **Bolivia came close to** meeting its target of 3.3%, **thanks to an income expansion** of over 1.5 **percentage points** of GDP, since spending **pressure increased, but only** slightly.

While in general the structure of current income was unchanged, the share < if tax revenues increased, from 9.3% to 10.5% of GDP. This was due to more efficient tax collection, which made it possible to increase the tax base 1 >y 2% through various tax inspection procedures. In 1994 there were no changes in the tax rates.

Current expenditure, meanwhle, rose only marginally (0.2% of GDP). Wages, interest payments and, in particular, transfers to the private sector increased in real terms. The increase in the wage bill included the severance payments made by the Regional Development Corporations to approximately 600 employees laid off as a result of the Populai Participation Programme, as well as compensation paid by the Corporación Minera de Bolivia (COMIBOL), some 3,000 of whose workers chose voluntary retirement.

The deficit was financed throi gh resources from international agencies, primarily the Inter-American Development Bank (IDE), the World Bank and the Andean Development Corporation; foreign grants and donations continued to make a significant contribution (2% of GDP). The public sector financed its cash requirements by issuing securities -treasury bills totalling US$ 92 million and municipal bonds worth US$ 3 million- so that domestic financing, through the ("entrai Bank decreased slightly.

b) **Foreign exchange policy**

The main aim of foreign excharge policy up until June 1994 had been to maintain a stable bilateral real exchange rate based on the dollar. To that end, minor devaluations had been carried out in order to close the gap resulting from the differences between nominal excha ige rates and domestic and foreign inflation rates.

Beginning in July, a broader objective was sought, namely, maintaining a stable multilateral exchange rate over the medium term, To that end, the Central Bank introduced a reference rate based on a basket of four currencies, -the dollar, the pound sterling, the yen and lhe deutsche mark- weighted according to their share of the

Table 1

BOLIVIA: MAIN ECONOMIC INDICATORS

	1987	1988	1989	1990	1991	1992	1993	1994''
				Growth rates				
Growth and investment								
Gross domestic product	2.6	3.0	3.5	4.7	5.1	1.2	4.1	4.2
Per capita gross domestic product	0.4	0.7	1.3	2.4	2.7	-1.2	1.6	1.7
Gross national income	4.7	1.6	3.9	4.3	3.0	-1.4	1.9	3.6
Gross domestic product by sector								
Goods	2.6	7.7	4.3	6.7	5.9	-0.9	4.6	5.1
Basic services	4.0	0.9	2.3	4.1	5.9	4.9	6.1	5.2
Other services	1.6	-1.3	3.2	2.3	4.0	3.8	3.2	2.8
				Percentages				
Contribution to growth of GDP '								
Consumption	3.8	2.4	3.1	1.3	0.9	3.1	2.6	2.5
Government	1.4	-0.5	0.3	-0.2	0.3	0.4	0.3	
Private	2.4	2.9	2.8	1.5	0.6	2.6	2.3	2.4
Gross domestic investment	1.9	-4.4	-1.3	0.6	4.1	1.2	-1.9	-5.3
Exports	-1.1	1.6	4.0	2.6	2.8	-0.6	4.8	6.3
Imports	-1.9	3.3	-2.2	0.2	-2.8	-2.5	-1.3	0.7
				Percentages of GDP				
Gross domestic investment	18.2	13.3	11.6	11.7	15.0	16.0	13.5	7.9
National saving	3.9	2.8	3.0	5.1	6.4	2.1	1.1	1.4
External saving	14.3	10.6	8.7	6.5	8.6	13.9	12.4	6.5
				Percentages				
Employment and wages								
Activity rate				50.4	51.3	51.7	50.7	52.5
Open unemployment rate [e]	7.2	11.6	10.2	9.5	7.3	5.8	5.4	5.8
Real minimum wage (Index: 1990=100)	123.7	129.3	117.4	100.0	164.5	164.8	179.9	198.4
				Growth rates				
Prices (December to December)								
Consumer prices	10.6	21.5	16.6	18.0	14.5	10.4	9.3	8.5
Wholesale prices	16.1	21.5	21.7	19.8	13.8	13.6	7.5	
External sector								
Terms-of-trade effect (Index: 1990=100)	114.3	103.2	104.0	100.0	94.1	74.0	74.6	79.8
Nominal exchange rate (bolivianos per dollar)	2.05	2.35	2.69	3.17	3.58	3.90	4.27	4.63
Real effective exchange rate (Index: 1990=100)	69.8	74.1	71.9	100.0	108.3	116.3	120.0	127.8
				Millions of dollars				
Balance of payments								
Current account	-526	-427	-399	-337	-422	-754	-689	-388
Balance of trade in goods and services	-263	-171	-158	-106	-194	-575	-498	-216
Exports	650	671	867	977	917	773	892	1 181
Imports	913	842	1 025	1083	1 112	1 348	1 390	1 398
Capital account	478	384	295	355	444	780	826	520
International reserves (variation)	-81	-35	-76	20	53	83	137	132
				Percentages				
External debt								
Public debt (as percentages of GDP)	119.1	103.5	81.8	68.1	59.1	62.7	61.9	68.1
Net interest , (on exports)	36.3	38.6	27.7	23.2	24.5	22.4	19.5	14.1

Table 1 (conclusion)

	1987	1988	1989	1990	1991	1992	1993	1994[a]
				Percentages of GDP				
Non-financial public sector								
Current income	27.0	28.0	28.8	25.7	26.2	26.1	26.8	28.4
Current expenditure	26.9	24.7	25.0	22.3	22.4	22.5	24.6	24.8
Saving	0.1	3.3	3.8	3.4	3.8	3.6	2.2	3.6
Capital expenditure (net)	7.1	9.1	8.6	7.3	7.5	8.4	8.0	7.8
Fiscal balance	-7.3	-5.8	-4.8	-3.9	-3.7	-4.8	-5.8	-4.2
				Growth rates				
Money and credit								
Banking system monetary balance								
Net international reserves	-14.0	1.9	-51.0	197.9	48.1	6.9	8.8	24.2
Net credit to the public sector				54.5	6.5	184.2	29.9	6.3
Credit to the private sector	45.2	34.6	42.0	41.1	47.8	45.7	39.3	12.9
Money (Ml)	39.9	34.7	3.1	17.6	25.2	19.0	14.6	33.2
Savings and time deposits in local currency					8.9	-19.5	7.8	63.0
M2					22.7	13.9	14.0	35.8
Dollar deposits					68.1	44.2	U.8	7.1
				Annual rates				
Real interest rates (annualized)								
On deposits			6.7	5.3	8.4	11.9	11.9	9.3
On loans			18.4	20.7	23.5	32.7	40.8	43.5
Equivalent interest rate in foreign currency [g]			2.8	8.4	12.2	12.4	12.1	12.1

Source: ECLAC, on the basis of official figures.

"Preliminary figures. Based on 1980 dollars at constant prices. [c] Measures the impact of the variation o f each aggregate on **the** growth of ODP. Derived by multiplying the annual rate of variation of an aggregate by the ratio of that a) gregate to GDP. [4] Percentages of the working-age population. ° Percentages of the economically active population. Refers to net balance-of-payments interest on exports of goods and services. ' Interest rate on deposits deflated by the variation in the exchange rate.

Table 2

BOLIVIA: MAIN QUARTERLY INDICATORS

	1992				1993				19!>4[a]			
	I	II	III	IV	I	II	III	IV	I	II	III	IV
Consumer prices (12-month variation, %)	13.2	12.6	12.1	10.4	7.6	7.7	9.5	9.3	7.9	7.7	7.0	8.5
Real effective exchange rate (Index: 1990<*100)	114.1	117.4	120.6	118.4	117.0	120.9	120.3	121.7	123.9	127.0	Î29.7	130.6
Real Interest rate (annualized, *%)*												
Ondeposits	-0.1	14.6	15.8	17.3	12.5	14.1	5.9	14.9	14.1	13.0	5.3	4.6
On loans	5.2	34.3	43.1	48.0	40.5	37.9	37.2	47.8	52.6	44.2	38.1	39.1

Source: ECLÀC, on the basis of official figures.
* Preliminary figures.

balance of payments. The official exchange rate managed by the Central Bank of Bolivia takes into account not only the real effective reference rate but also cyclical fluctuations in the foreign exchange market.

In a continuation of the trend seen since 1990, the nominal exchange rate rose by around 5% during the first half of 1994; in the second half, however, with the use of a new methodology, it increased by slightly under 2%. Meanwhile, the average annual real exchange rate -weighted, that is, against a basket of currencies of Bolivia's main trading partners- continued to increase, this time by over 6%, reaching a record high.

c) **Monetary policy**

Monetary policy has thus become mainly a passive tool, subject to the demand of economic agents for real balances. However, in late 1994, the Central Bank's provision of massive financial assistance tò two institutions which had become insolvent led to a sudden expansion of money creation and a simultaneous contraction of bank reserves. This resulted in a sizeable increase (37%) in the amount of money in circulation.

In fact, gross credit to the rest of the financial system was exceptionally high, owing to the closing and subsequent sell-off of the Sur and Cochabamba banks ordered by the Bank Supervisory Authority in late November 1994. Given the Central Bank's role as the lender of last resort, these banks sought loans for the refund of deposits. Deposits under US$ 5,000 were refunded in bolivianos; deposit refund certificates were used for higher amounts.

The monetary balance of the consolidated banking system showed an expansion in the money supply of around 33%. Savings and time deposits in bolivianos expanded by almost two thirds, in response to the continuing high dollar equivalents of domestic interest rates in local currency (12% per year, which remained consistently above the devaluation rate, and the measures taken to increase the percentage of financial liabilities in local currency. Nevertheless, this sizeable increase had only a minor impact, as dollar-denominated deposits, which grew by only 7%, continued to represent 80% of the banking system's total currency liabilities.

The expansion of these liabilities was attributable mainly to the increase in international reserves (24%) and in credit to the private sector (13%). For the second year in a row, net international reserves re se substantially, this time by US$ 132 million, reaching a peak of some US$ 500 million in late 1Í >94.

d) **Structural reforms**

In 1994 Congress approved the constitutional reform, which took effect in August. The educational reform was adopted at mid-year, and generous support for its impleme ntation has been received from international r lultilateral and bilateral agencies. The programme to capitalize public enterprises made legislative headway. Moreover, Congress ratified the Popular Participation Act giving greater autonomy to municipalities, which entered into force in mid-1994.

Towards the end of the year, the Bolivian Government and the International Monetary Fund (IMF) reached agreement on a new programme under the enhanced structural adjustment facility, which establishes a medium-term economic programme covering the period from 1 October 1994 to 31 December 1997. It emphasizes the maintenance of macroeconomic stability, the educational and pension reforms, the civil ser'ice programme and the capitalization of thi; major public enterprises, in an effort to improve the climate for investment and to bolster essential public services.

The programme calls for raii ing the real GDP growth rate from around 4% iii 1994 to 6% in 1997, while at the same time gradually reducing the inflation rate to 5% per year. The non-financial public-sector deficit might increase to 4.4% in 1995, but will fall to 2.7% in 1997. The projections include an increase in international reserves of some L S$ 40 million to US$ 50 million per year.

3. Trends in ti main variables

a) Economic activity

The gross domestic product, driven by exports of goods and services, rose again by 4%, which, except during 1992, has been the trend rate seen since 1989. Thus, Bolivia has gradually been able to regain, at a rate of 2% per year, much of the per capita GDP which it lost during the first half of the 1980s;

In fact, the 20% increase in the physical volume of exports was a key element in the expansion of overall demand, since domestic demand dropped 3%. A significant aspect of this trend was the sharp contraction of investment in both fixed capital and inventories, to the point where the gross domestic capital formation/GDP raio M below 8% in 1980 dollars, its lowest figure in many years. The paltriness of that figure stands out even more sharply considering that external saving accounted for 6.5% of GDP, which means that domestic saving levels were very low; Private consumption, meanwhile, grew at a moderate pace, while public consumption stagnated against the backdrop of an austerity programme.

While total demand expanded, it did so more slowly than iB previous years. This directly affected imports, which dropped by nearly 3% in real terms.

The output of basic goods and services grew faster than total output, while the production of other services continued to slacken gradually.

Electricity generation showed the greatest momentum (13%), capping seven years of strong expansion. Mining also grew significantly (by over 6%), largely because of increased petroleum and natural gas drilling, which was up by more than- 11%. Other mining activities grew 3%, which was drastically lower than the 1993 figure (11%). Tungsten, antimony, gold and silver mining increased, while tin, zinc, copper and lead mining declined. Medium-scale mining grew sipificantly, while State-owned and small-scale mining declined.

The pace of agricultural expansion accelerated to almost 5%. For the second year running, industrial crops intended mainly for export, suchas cotton, sugar cane, sunflower and soya, exhibited high growth rates. For soya, in particular, international prices and the growing foreign demand for pulses and their by-products, especially from the Andean Group countries, made possible a major growth ol soya exports. Meanwhile, coca production dea eased because of the eradication programme carried out in regions deemed to be overproducing it, notably El Chapare in the Department of (^ochabamba.

The accelerated rise of manufacturing continued; manufacturing expanded by almost 5% in 1994, but growth was mon: even than in 1993. In the first place, only two se ctors declined (plastics and basic non-ferrous met ils), as against seven sectors in 1993. Furthermore, tobacco, clothing, industrial chemicals, oilier chemicals, and glass and glass products all grew by over 10%. Construction slipped again, g rowing by just 2%, owing to the fall-off in public investment during the first half of 1994 and to a slowdown in private construction.

b) Prices, wages and employment

Consumer prices continued ta follow the downward trend seen in recent years; their 8.5% increase in 1994 was the lowest since 1976, although still above the target of 7 5%.

The trend in the exchange rate w¡ is the primary factor influencing this state of affa irs. However, in the last two months of the year, the growth in the money supply, combined with the inflation imported from Brazil and Peru, reversed this trend, a situation which lasted into early 1995. The prices of food, beverages and housing rose faster than other prices. From a regional standpoint, the sharpest increase was seen in Cochabamba, and the lowest in La Paz.

Wage trends were fairly unifoim, since the real minimum wage rose 10%, while the average private-sector wage increased by almost 9%. Public-sector compensation inceased by a smaller amount.

The Bolivian mining sector was restructured through a programme which increased the proportion of private enterprises of relatively high capital intensity, while reducing that of traditional mining enterprises, especially

State-owned and small-scale companies. This change made it possible to raise the average wage in the mining sector.

There was no significant change in the unemployment rate. A slight increase in open unemployment coincided with a faster pace of economic growth, indicating that the demand for labour increased more rapidly than the supply.

c) **The external sector**

The 32% increase in the value of exports of goods and services, while imports remained sluggish, narrowed the trade deficit sharply to 3% of GDP, less than half the previous year's figured

For the first time, non-traditional exports surged ahead of mining to form the leading export category. This impressive performance was due to sales of jewellery items, jnainly gold-based, totalling US$ 142 million (a dramatic increase over the US$ 58 million worth sold in 1993 and the paltry US$6 million worth in 1992); soya (totalling US$ 119 million in 1994 as against US$ 74 million in 1993); and wood, which rose from US$ 53 million in 1993 to US$ 86 million in 1994.

The explosive growth of jewellery exports is attributable to the establishment of inbond-assembly *(maquiladora)* enterprises which import gold for jewellery manufacturing. Some of these enterprises are no longer solely maquilas, as they handle the entire production process, using Bolivian gold.

Meanwhile, gold also played an outstanding role in mining exports, which rose 14%; gold thus became the leading export product in this category, displacing zinc, exports of which fell by 12%. The biggest markets for Bolivian exports were the United States (23%), the United Kingdom (20%), Argentina (16%, especially for natural gas), Peru (10%, especially for soya), Belgium (6%) and Colombia (5%, especially for soya oil).

In contrast, the value of imports (nearly US$ 1.2 billion) was similar to what it had been in 1993, as prices rose in the same proportion (3%) as volumes fell. The increase of around 26% in consumer goods purchases contrasted with the 13% drop in capital goods purchases, especially for industry. Purchases of intermediate goods increased by somewhat less than 7%, as demand dropped in agriculture and construction and rose in industry and fuels.

The main import suppliers wsre the United States (25%), Argentina (12.5°/ *o)*, Brazil and Japan (both 11%) and Chile (8%). Approximately 40% of Bolivian imports originated in the Latin American Integration Association (LAIA) area and 20% in Europe.

The balance-of-payments deficit on current account was more than offset through external resources, so that international reserves increased for the fifth consecutive year. Unrequited official transfer payments constituted a significant share oJ capital flows, rising by 12% to reach their highest level in the past 10 years (equal to slightly less than 4% of GDP). The largest donors were the United States (US$ 101 million), Argentina (U5$ 51 million), Switzerland (US$ 28 million), Japan (US$ 17 million), the European Union (U 5$ 13 million), and IDB (US$ 12 million).

During 1994 Bolivia received US$ 350 million in foreign loans, or 7% mere than in 1993 (consisting of 52% concessional debt and 48% commercial debt), of which US$ **Í188** million was provided by multilateral agencies and US$ 62 million by bilateral agencies. Among the multilateral lenders, IDB stood oui, with US$ 136 million, as did the Andean Development Corporation (ADC) (US$ 72 million and the World Bank (US$ 68 million). Among the bilateral lenders, the biggest flews were from Germany (US$ 27 million), Spain (US$ 15 million), France (US$ 9 million) and Japan (US$ 7 million). These disbursements were earmarked mainly for the execution of multisectoral projects channelled to the private sector and for the energy, water and transport sectors.

By late 1994 the medium- and long-term public external debt balance had reached US$ 4.2 billion, which was equal to an 11% increase, the fastest in the past eight years. A share of this increase was due 13 the increased value of debts denominated in cuirencies that had appreciated against the dollar.

The multilateral public exterral debt rose by 13%; there were notable increases in the debt incurred to ADC (35%), the world Bank (13%) and IDB (10%). Meanwhile, the bilateral public debt increased by 10%. A breakdown of Bolivia's public external debt shows a higher percentage of multilateral creditors (56%) followed by bilateral creditors (43%), while borrowing from the private sector represented only 1% of the total. The Inter-American Development Bank (57%), the World Bank (32%) and ADC (7%) stood out among the first group, while the biggest bilateral creditors were Japan (32%), Germany (22%) and Belgium (9%).

In March 1994 the central batiks of Bolivia and Brazil signed a memorandum of understanding stipulating that Bolivia's total debt to Brazil, which amounts to I IS$ 68 million, would be paid off in three instalme nts (40%, 30% and 30%) through the purchase o;'United States Treasury 25-year zero-coupon bonds. Bolivia made the first payment on 30 June, purchasing US$ 10.9 million worth of these bonds, which reduced its debt by US$ 27.5 million.

BRAZIL

1. General trends

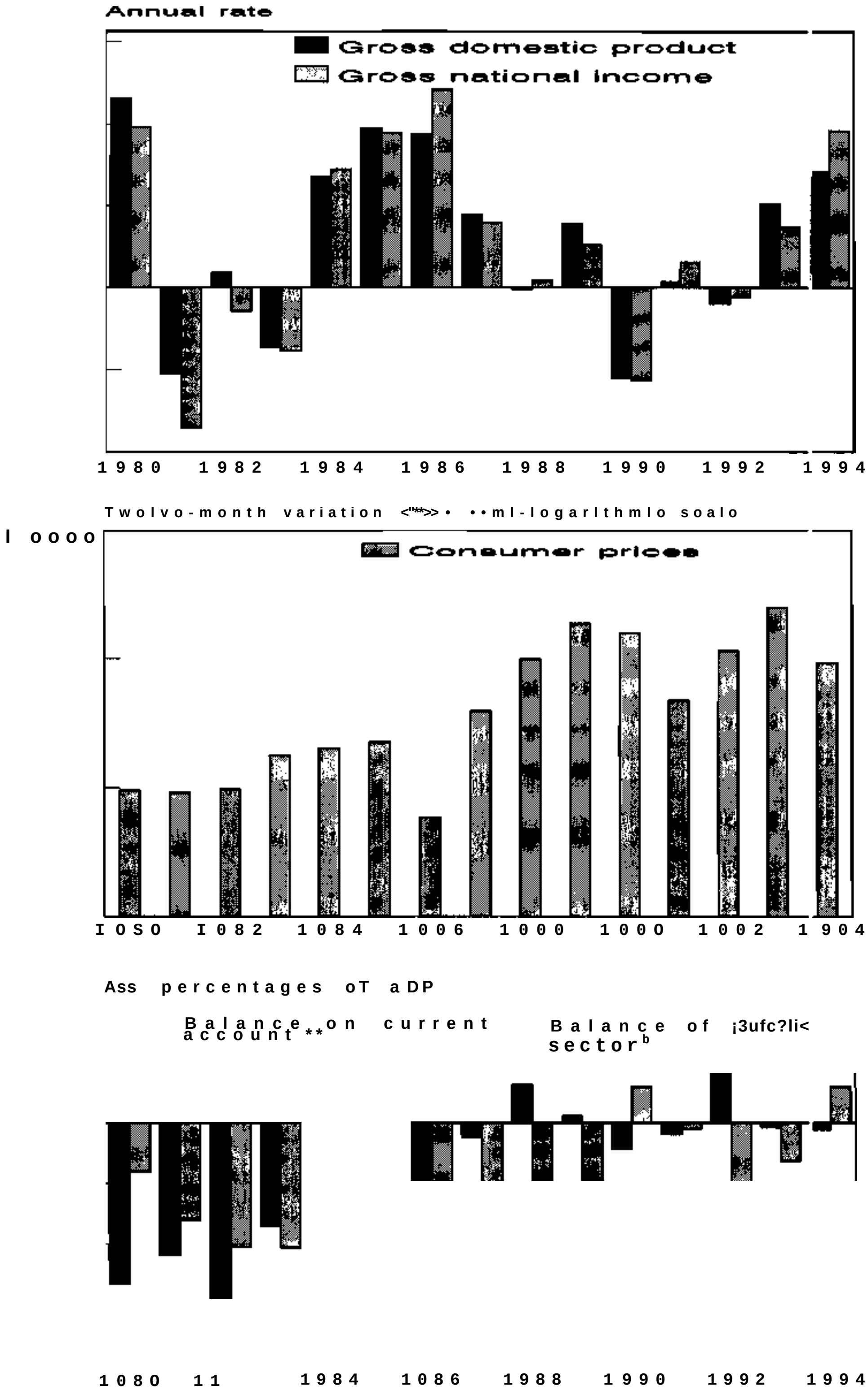
The performance of the Brazilian economy in 1994 was strongly influenced by the implementation of the Real Plan, which -in contrast with the seven previous stabilization programmes that Brazil had tried out over nearly a decade- succeeded in slashing what had become a runaway inflation rate. The plan was implemented in the midst of the election campaign to fill executive and legislative seats at the federal and state levels. The new administration which took office in January 1995 embraced the main thrust of its predecessor's economic policy and confined itself to making adjustments to strengthen the stabilization programme.

Thus, the inflation rate fell from 5,000% in the 12-month period ending in June 1994 to only 34% in June 1995. The country's gross domestic product (GDP) expanded by almost 6% in 1994, thus marking up its highest rate since 1987, and its pace of growth picked up even further in the first quarter of 1995, when it reached an annualized rate of 10%. Per capita GDP climbed by nearly 4%, although it still fell short (-4%) of its 1989 level. The balance of payments showed a small deficit (US$ 1.5 billion) on current account, but the capital account posted a surplus of US$ 8 billion. For the third year in a row, the country increased its international reserves considerably, adding over US$ 7 billion in 1994, which brought them close to the US$ 39 billion mark. Meanwhile, May 1994 saw the conclusion of negotiations with creditors for the rescheduling of Brazil's external debt service. The unemployment rate slipped from 5.4% to 5.1% and the average wage in the manufacturing sector in São Paulo increased by about 10%. On the fiscal policy front, a more determined effort to keep public accounts under control enabled the public sector to build up a larger primary surplus than in 1993 (the equivalent of ¿ .1% of GDP), which gave it an operating surplus amounting to 1.2% of GDP.

In contrast with previous stabilization initiatives, the new plan was notable for its transparency regarding the meisures to be adopted and the timing of their implementation; it also ruled out the use of price freezes, intervention in contracts, or any Dther type of drastic or unexpected action. The plan was divided into three stages, each cf which was announced and outlined in December 1993. The first stage involved a fiscal adjustnent aimed at balancing the budget in 1994. The second stage, which began in March 1994, sought to coordinate the economy's prices by creating a new unit of indexation. The third stage of ttie plan was launched in July with the introduc ion of a new currency, the *real;* this stage also called for modifications in exchange and monetary policies, and extended the life of most indexed financial contracts.

Its results were both immediate and spectacular, but they did not spell the end of inflation. It was not until mid-1995 that action was taken to consolidate the stabilization process and consolidate a sustained form of economic growth. To this end, the administration embarked upon the legislative process necessary to amend the Constitution with a view to streamlining State monopolies, lifting restrictions on foreign capital, reforming the tax system and the management of the public sector, and making thorough-goin¡; changes in the social security system. In addi ion, in June the initial steps were taken to all but dismantle those mandatory indexation mechanisms still in force, which had required that annual adjustments be made on the bisis of past inflation.

Figure 1
BRAZIL: MAIN ECONOMIC INDICATORS



Oourœ: ECLAC, on th« Pasls oT offlolal figuras.
• Of th« balanoe of payment». b Estimated on trie» basis of trie oonsolldatsd pupilo seotor's flnanolng requirements

The need for such structural reforms lay in the fact that, the plan's successes notwithstanding, there had also been some developments that jeopardized the consolidation of the stabilization process. These included the reappearance of inflationary pressures, which had thwarted efforts to push the monthly rate of increase in the consumer price index (CPI) below 2%; a strong expansion of demand; the danger that indexation mechanisms would again come into widespread use; and the withdrawal of external financing in the wake of the Mexican crisis. These problems were exacerbated by exchange-rate lags and the difficulty of controlling liquidity. One particular cause for concern was the fact that the country's foreign trade in goods had taken a definite turn for the worse following the introduction of the new plan. The US$ 13 billion surplus recorded in 1993 narrowed to US$ 10.4 billion in 1994, and the monthly balances, which had been consistently positive ever since 1987, began to slip into the red in November 1994; as a result, a cumulative deficit of US$ 4.26 billion was incurred in the first six months of 1995. This abrupt turnaround was attributable to a surge in imports, whose monthly levels junped from just over US$ 2 billion in the first half o E1994 to some US$ 4 billion in the final quarter o f that year and to almost US$ 4.3 billion in the fin t half of 1995. Exports mounted at a satisfactory pace, but considerably more slowly than im sorts.

The introduction of a new currency also triggered major changes in other components of the balance of payments, which ¡iwung from a surplus of US$ 8 billion in the fi-st half of the year to a deficit of just over US$ 1 billion in the second. In addition to the turnabout in merchandise trade, net inflows of loreign capital thinned substantially, dropping to a meagre US$ 770 million. This setback wns attributable to widespread uncertainty as to whether the monetary authority would impose stricter controls on such flows, delays in implementing the privatization programme and a considerable appreciation of the local currency, even in nominal terms.

2. Economic policy

Brazil's new stabilization plan, which had been launched late in 1993, was the cornerstone of its economic policy in 1994. In order to achieve its first objective, which was to put the country's fiscal accounts in order, a number of reforms were introduced which were designed to improve the use of public resources. To the same end, the collection of social security contributions was brought up to date, a new tax came into effect and the debts of states and municipalities were rescheduled. The striking drop-off in inflation helped to moderate the erosion of tax revenues.

Once the public sector's accounts had been brought under control, the plan moved into its second stage, whose purpose was to coordinate price formation within the economy. Previous stabilization initiatives undertaken in Brazil had involved the use of price freezes, but experience had shown that this mechanism not only directly interfered with the operation of contracts, but also frequently generated lags in prices, which then remained far below the inflation rate. In other instances, economic agents had created a variety of indexes for use in correcting prices, contracts and obligations in an eff *M* to protect their real incomes. For example, virtually all 26 states, the Federal District and the country's major cities had established units of account for the calculation of taxes based on local or national indexes. In order to standardize these mechanisms, the federal govern» tient created what it termed a "unit of real value" (URV), which was calculated on the basis of an average of three price indexes.[1] The daily pri ce of the URV in *cruzeiros reales* was set by the (Central Bank on the preceding day. The *VRV* was also calculated retroactively so that the fue historical values of various prices could be determined. In addition, the Central Bank announced that it would use the URV as a reference for its

[1] These were the consumer price index for the city of São Paulo developed by the Institute of Economic Reset xch Foundation (PIPE), the special broad-based national consumer price index prepared by the Brazilian Geographical and Statistical Institute (IBGE), and the general price index computed by the Getúlio Vargas Foundation.

Table 1

BRAZIL: MAIN ECONOMIC INDICATORS

	1987	1988	1989	1990	1991	1992	1993	1994[a]
			Growth rates					
Growth and investment								
Gross domestic product	3.6	-0.1	3.1	-4.4	0.3	-0.8	4.1	5.7
Per capita gross domestic product	1.6	-2.0	1.2	-6.1	-1.5	-2.5	2.4	3.9
Gross national income	3.2	0.3	2.1	-4.5	1.2	-0.5	3.0	7.7
Gross domestic product by sector								
Goods	3.8	-2.3	3.0	-7.7	-1.1	-1.7	4.8	7.4
Basic services	5.2	6.2	6.7	1.7	7.7	0.3	9.6	5.3
Other services	1.7	1.0	2.6	-2.2		-2.1	1.4	1.3
			Percentages					
Contribution to growth of GDP								
Consumption	1.6	-0.8	3.0	-1.0	0.9	-1.8	3.9	4.8
Gross fixed investment	-0.3	-0.9	0.2	-1.8	-0.5	-1.3	1.3	2.6
Exports	2.0	1.5	0.6	-1.0	0.6	2.8	1.6	1.0
Imports	0.2	0.1	-0.6	-0.7	-0.8	-0.4	-2.7	-2.8
			Percentages of GDP					
Gross fixed investment	17.4	16.5	16.2	15.1	14.6	13.3	14.1	15.8
National saving	16.8	18.0	16.5	13.9	14.1	15.6	13.9	15.3
External saving	0.5	-1.5	-0.3	1.2	0.5	-2.2	0.2	0.5
			Percentages					
Employment and wages								
Activity rate [e]	4.0	4.2	3.7	4.5	4.8	4.8	5.4	5.1
Open unemployment rate (Index: 1990=100)	117.1	129.9	133.1	100.0	112.1	102.5	113.0	107.4
			Growth rates					
Prices (December to December)								
Consumer prices	394.6	993.3	1 863.6	1 585.4	475.8	1 172.0	2 497.6	929.3
Wholesale prices	407.2	1050.1	1748.8	1 449.5	471.7	1 154.3	2 639.5	920.6
External sector								
Terms of trade (Index: 1990=100)	106.2	116.3	104.0	100.0	104.7	103.3	102.9	108.1
Nominal exchange rate (reales per dollar) [g]	0.0143	0.0953	1.0305	0.00003	0.00015	0.00164	0.03215	0.64250
Real effective exchange rate (Index: 1990=100)	156.8	143.2	108.4	100.0	118.5	127.7	115.4	91.0
			Millions of dollars					
Balance of payments								
Current account	-1407	4 172	1007	-3 809	-1443	6 266	-608	-1451
Trade balance (goods and services)	8 830	16 187	13 385	7 485	7 485	12 301	8 068	4 833
Exports	28 157	36 046	37 495	34 661	34 369	40 005	42 896	48 525
Imports	19 327	19 859	24 110	27 176	26 884	27 704	34 828	43 692
Capital account	3 572	-2 461	693	5 054	1640	8 802	9 821	7 965
International reserves (variation)	1800	2 114	1586	1139	209	15 001	8 811	7 344
			Percentages					
External debt								
Gross debt (as a percentage of GDP)	21.0	18.2	16.1	16.1	16.0	16.3	15.7	13.2[1]
Net interest (as a percentage of exports)	31.2	27.3	25.7	28.1	25.1	18.3	19.7	13.2

Table 1 (conclusion)

	1987	1988	1989	1990	1991	1992	1993	1994[a]
				Percentages of GDP				
Non-financial public sector								
Current income	23.5	20.5	20.9	25.5	21.7	21.2	21.1	22.0
Current expenditure	29.2	25.3	25.8	24.3	21.9	24.0	22.4	20.8
Financial balance	-5.7	-4.8	-6.9	1.2	-0.2	-2.8	-1.3	1.2
				Growth rates				
Currency and credit								
Monetary balance of banking system	27.9	15.0	3.0	-5.7	-6.0	152.5	35.6	20.5
Money (Ml)	128.2	570.3	1384.2	2 335.7	330.7	896.5	2 129.4	2 622.5
				Annual rates				
Real interest rates (annualized)								
On deposits	...	-11.0	57.1	3.3	34.7	31.9	23.0	26.0
On loans				405.8	89.6	196.8	Ü29.1	301.0
Equivalent interest rate in foiteigfl currency		-7.6	108.1	6.4	30.2	40.8	27.0	54.6

Source: ECLAC, on **the** basis of official figures.
[a] **Preliminary figures.** Based on 1980 dollars at constant prices. [c] These entries measure the impact <f the variation in **each aggregate on the** variation in GDP. The coefficientes were obtained by multiplying each aggregate's anni al growth rate by **the level of that aggregate** as a percentage of GDP. Includes variations in inventories. [c] Percentages oi ' the working-age **population.** **Percentages** of **the** economically active population. [g] Interest rate on deposits, deflated by the variation **in the exchange rate.**

Table 2
BRAZIL: MAIN QUARTERLY INDICATORS

	1992				1993				1994'			
	i	n	in	iv	i	H	m	rv	i	n	m	iv
Gross domestic product (Index: 1990-100)	**110.6**	121.8	119.2	114.7	113.8	128.0	124.2	119.8	119.3	131.6	131.7	130.8
Consumer prices (12-month variation)	**574.6**	887.9	1120.6	1172.0	1243.3	1467.1	1905.7	2 497.6	3 490.7	5 015.3	2:01.8	929.3
Real exchange rate (lode*: 1990*100)	**130.2**	123.2	131.7	125.7	119.5	117.7	112.4	112.0	105.7	102.8	82.4	73.0
Real interest rate (annualized)												
On deposits	**46.5**	**8.6**	49.7	22.8	**6.8**	35.3	22.2	27.8	35.5	43.0	**7.8**	17.8
Onlqans	**290.9**	**191.9**	210.5	93.8	131.8	203.1	92.0	489.4	630.8	399.1	73.0	101.3
Money supply (Ml) (12-month variation)	. . .	. . .	. . .	896.5	1059.2	1207.7	1466.7	2*129.4	3 167.6	5 879.2	5 753.1	2 622.5

Source: ECLAC, **on the** basis of official figures.
'Preliminary figures.

operations in the foreign-exchange market. The new index could only be used in the case of contracts with a life of more than one year.

Wages were converted to URVS on a mandatory basis; their average value for the four-month period from November 1993 to February 1994 was used in calculating their conversion based on the day on which the wages had been paid. Thus, from March on, wages were completely indexed, although they were paid in *cruzeiros reales* according to the price of the URV on the day of payment. URV-denominated wage levels could be raised only during each job category's annual round of wage bargaining in those cases where it could be demonstrated that the real level that had previously been calculated had been lower than their average real level during the preceding 12 months. The Government encouraged the private sector to convert its prices to URVs, but it stipulated that the new value should not exceed the average for the final quarter of 1993.

Between April and June, public utility charges and rates (for electricity, telecommunications services, petroleum supplies and water) were converted to URVs, and here again the real average value method was used. However, the guidelines for converting rent payments and private school tuition were not announced until after the new currency was brought into use. These two activities implemented their own conversion guidelines, however, and this caused their adjustments to be higher than they would have been if the average real value method had been employed.

The introduction of the URV gave rise to a new relative price structure, but the simultaneous indexation of wages prevented this from precipitating a sharp decrease in income levels. The reduction in uncertainty paved the way for the gradual reappearance of credit mechanisms -especially for retail trade- which had virtually been wiped out by the country's earlier high inflation rates. This buttressed the upward trend in economic activity which had already been in evidence throughout 1993.

This slow, orderly adjustment of relative prices was upset, however, when the introduction of the new currency was announced in June. The private sector was very concerned about how prices might behave under the new monetary regime, and private economic agents therefore widened their profit margins substantially; this, in turn, caused the monthly rate oi price increases to rise from 43% in May to 48% in June.

The introduction of the new currency, which entered into circulation on 1 July, differed in important respects from the four previous currency changes implemented in Brazil since 1986. First, it was stipulated thîit one *real*, the new currency, would have the sa lie value as the URV had as of 30 June, or 2,750 *c 'uzeiros reales*. The actual process of replacing the individual currency units then circulating outside banks with more than 3 billion new bill» and coins was accomplished without any major setbacks, thanks to the broad-based structure of the banking system and the experience which economic agents had gained in using conversion factors for different indexes.

The Government also pledgïd to maintain international reserves at a level e quivalent to the total value of *reales* in circulation, as well as placing a cap on currency issues ; nd establishing new fiscal restrictions. The adoption of the *real* brought about drastic changes in monetary and exchange policies, thus calling into question some of the guidelines recently developed by the authorities themselves. The Central Bank withdrew from the foreign-exchange market, which triggered a sharp apprécia ion of the *real;* at the same time, in responso to the rapid expansion of the demand for meney, it injected liquidity into the economy by purchasing government securities from the private sector. Meanwhile, the National Treasury adopted a tight money policy, and reserve lequirements on bank deposits were raised.

The problems created by the introduction of the new currency were considerably greater than had been expected. The level of < onsumer prices climbed steeply in July and Aug ist, marking up a cumulative rate of 12% for the se two months. This was due both to the effect!; of the upward spiral in the prices of manufactures observed in June, prior to the adoption of the new currency, and the impact on agricultural (rices of supply problems caused by severe frosts which devastated production area:;. Once these situations had been overcome, in nation subsided so rapidly that by September the rate of price increases was under 1%. This trend was reversed once again during the next two months, however, when the effects of a protracted drought were reflected in the prices of livestock products, thus boosting the monthly rate of price variations to over 2%. In December the impact of this situation Started to taper Off as the supply of meat and meat products began to increase.

As with other stabilization initiatives, the Real Plan's effects on tradables and non-tradables were quite different. Prices of services in general, as well as rents, exhibited a momentum all of their own, and recorded above-average increases. Between July and December, the upsurge in the housing component was twice that of the general index. Meanwhile, wholesale prices of manufactures remained virtually unchanged between August and December.

The slackening of inflation contributed to a rapid build-up of purchasing power, especially among low-income groups, which had traditionally been bypassed by the financial system's indexation mechanisms. The slowing of inflation, and the resulting decrease in the cost of money, made it possible for lenders to extend more credit and to do so over longer terms; this meant that installment payments represented a much smaller percentage of monthly wages, which stimulated commerce. In the State of São Paulo, sales during the second six months of the year were about 30% higher, in real terms, than in the same period of 1993.

Consumer credit played a particularly important role in the expansion of sales. Four months into the plan's implementation, the total amount of loans granted by the financial system to the private sector was 43% higher than it had been at the end of June, and direct consumer loans had jumped 120%; this situation prompted the authorities to tighten up credit controls.

Nominal interest rates plummeted in the second half of the year, but then held at around 4%. Real interest rates fluctuated, but remained positive. As state banks ran into financial difficulties, the targets set for the management of monetary aggregates became meaningless.

These changes in the exchange system were coupled with lower tariffs and the deregulation of external trade in order to foster the growth of imports. Measures along these lines included a reduction in the tariff on a variety of electronic goods and motor vehicles to a rale of 20%; the early implementation of planned lariff rollbacks in order to bring tariff levels inte line with the common external tariff maintained by MERCOSUR; the elimination of tariffs on a range of equipment and intermediate goods, such as petrochemicals and aluminium; and the application of low tariffs on external mail-order purchases.

These measures led to a vigorous expansion of imports during the second half of 1994. The turnaround in the balance of trade that began to develop in November was part of the stabilization strategy and was aimed at ensuring a high level of supply, enhancing the competitiveness of Brazilian troducts and increasing the demand for foreign exchange in order to soak up the growing supply of external resources. Thus, the appreciation ol the exchange rate initially served as an anchor for the stabilization process, until such tiro; as structural reforms could be introduced ir both fiscal accounts and the financial system.

The steep devaluation of the Mexican peso which occurred in the final days of 1994 seriously compromised this strategy by sparking an immediate withdrawal of capital flows and heightening doubts as to the sustair ability of the considerable amount of financing needed to cover the balance-of-payments current account. In addition, this atmosphere of uncertainty bolstered the arguments of some segments of the business community regarding the pace of the liberalization process and the need to bring the exchange rate back to where it had been, in real terms, prior to the implementation of the plan.

a) Fiscal policy

Putting the public sector's ac:ounts on a sound footing was essential to the stabilization plan's success. This had been the goal of the constitutional reforms of February 1994, which provided for a 20% reduction ir mandatory allocations of taxes and sociil security contributions, thus allowing the ac ministration greater flexibility in its use of fiscil resources. Another factor contributing to the fiscal adjustment was the strong upturn in real tax revenues made possible both by the regularization of social security contributions, which had been disputed in the courts, and by the application of a provisional tax on financial transactions. The smaller real decrease seen in tax receipts when inflation dropped off sharply (known as the Tanzi effect) during the second half of the year exerted a similar influence. Furthermore, a law was passed under which the debts owed by states and municipalities to the federal government were rescheduled over a 20-year term; this law also stipulated that at least 11% of these administrative units' net receipts must be used to service those debts.

As part of the third stage of the plan, in mid-1994 the Government took further steps to balance the public sector's accounts and thus head off the plan's demise. No new external borrowing was allowed and requests for increases in budget appropriations were denied.

An analysis of the year as a whole leads to the conclusion that the Government's fiscal policy worked well in terms of both income and expenditure. The one-year tax on financial movements brought in more than US$ 4 billion in additional receipts. As regards expenditures, the Social Emergency Fund made it possible to use receipts from social security contributions to pay for activities which had previously been financed from other sources. In addition, the 1994 budget was not approved until October, which forced the federal government to hold down its current expenditures so as not to exceed its monthly allotments, which were calculated on the basis of the original budget proposal.

These promising developments notwithstanding, spending by the National Treasury did expand owing to an increase in the wage bill (including social security benefits) from US$ 23 billion to US$ 29.3 billion and an upswing in other current disbursements (excluding interest payments) from US$ 11.3 billion to US$ 13.1 billion. The central government's outlays on interest payments remained at around 1.4% of GDP, and its real 17% gain in income therefore allowed it to post a primary surplus equivalent to 2.7% of GDP and an operating surplus of 1.2%. The various states and municipalities, as well as State enterprises, did not do so well, since their operating deficits actually widened.

The solid advances made in the area of public-sector accounts in 1994 and the tight money policies adopted by the Treasury during the second six months of the year combined to give the Government a fair amount of manoeuvering room, and it was Iherefore able to avoid the problems that would have arisen if it had been forced to delay making essential changes in the fiscal policy fnmework in the areas of tax reform and spending controls. In addition, a portion of the inconie derived from the monetization of the federal debt was transferred to states that were having difficulty placing their debt paper on this market; these instruments were replaced with federal government securities, with the Central Bank serving as the intermediary. Nïvertheless, the states' problems persisted, and late in the year the authorities had to intervene in the two largest state banks, the Banco do Estaco de São Paulo (BANESPA) and the Banco do Estado do Rio de Janeiro (BANERJ).

b) **Exchange policy**

In an environment marked by strong inflationary pressures, economic uncertainty and sizeable capital inflows, the Government held to its policy of maintaining a sliding parity during the first six months of 1994 in an effort to preserve the stability of the real exchange rate and thus stave off any serious inbalances in the current account. The Central I lank bought up large amounts of foreign exctange while the debate continued as to whether or not additional restrictions on inflows of exernal financial resources were needed in older to provide monetary policy-makers with greater manoeuvering room.

When the new currency was introduced, the Central Bank announced that it would maintain international reserves at a level equivalent to the total value of *reales* in circulation; it also pledged to fully meet the demand for fon sign exchange at a one-to-one parity.

However, no sooner had the new currency been adopted than exchange po: icy underwent a complete change in direction breaking with previous plans and even with the guidelines formulated by the authorities themselves just days before. In a departure from its normal practices, the Central Bank withdrew from the foreign-exchange market as of 1 July, allowing the price of the dollar to be determined by supply and demand. Since there was a definite oversupply of dollars (both from exports and from capital inflows) which was driving up international reserves and the money supply, the currency appreciated significantly, with the exchange rate reaching 0.82 *reales* to the dollar in November. The real exchange rate, too, reflected a steep rise in the currency's value (28%) between June and December. In the last quarter, the Central Bank stepped back into the market, although on a smaller scale, to avert a major downturn in the nominal exchange rate.

In an effort to deal with the country's growing merchandise trade deficit, in March 1995 the authorities instituted an explicit system of currency bands in order to strengthen the real exchange rate; this led to an immediate nominal devaluation on the order of 6%. An increasing level of uncertainty in the economy was evidenced by a severe erosion of international reserves. Urgent adjustments were made in the exchange-rate mechanism, but the system of currency bands remained in place. In June, the bands were shifted upward in a move which, unlike the measures adopted in March, were greeted with equanimity by economic agents. In the second quarter of 1995, international reserves began to rebound to the levels recorded prior to the outbreak of the Mexican crisis.

c) **Monetary policy**

The monetary policy applied during the first half of 1994 was a continuation of the policy pursued in the final months of 1993. Real interest rates had been raised in September 1993 in an attempt to sterilize the bulk of the monetary expansion generated by the Central Bank's large-scale purchases of foreign currency.

With the introduction of the *real,* the Central Bank sought to anchor the currency by establishing quarterly caps on currency issues, although it reserved the right to raise that ceiling by up to 20%. Freed from the need to intervene in foreign-exchange operations, following its withdrawal from the currency mar cet, the Central Bank was able to boost the supply of liquidity in the economy by buying governnent securities from the private sector. The contractive role played by the National Treasury owing to the favourable outturn of its primary accounts, facilitated matters. In order to ward off an over-expansion of liquidity, on th<; very day that the new monetary regime entered into force the Central Bank raised the reserve requirement on any increase in demand deposits to 100% and the minimum reserve on time and savings deposits to 20%.

The rapid expansion of credit w hich occurred early in the second half of 1994 prompted the authorities to tighten up controls on financial institutions. Accordingly, in September the Central Bank raised the reserve requirement on time and savings deposits from 20% on any increase in such deposits to 30% of their total amount. In October a reserve requii ement of 15% was applied to all bank loan operations in an effort to cut down on exporters' us e of overseas lines of credit to finance domestic transactions. In addition, restrictions were placed on the use of non-bank financial intermediation mechanisms.

The behaviour of the monetary **t** ase was quite uneven in 1994. It shrank during tfce first half of the year, falling from the equivale: it of 0.8% of GDP in late 1993 to 0.5% the following June. In the second half of the year, howeve:, it expanded so swiftly that by year's end it had risen to 2.5% of GDP. The main components of he monetary balance followed a similar trend, w ith a striking contrast being observed between lhe country's level of external assets in the firs and second halves of the year.

Another factor that had a major influence on the behaviour of the monetary base was the assistance furnished to government banks. The first six months of 1994 saw no mon than a slight increase over the meager level recorded at the end of 1993, but this variable shot up during the second half of 1994 to more than 29! • of GDP. The accounts corresponding to ojien-market operations also underwent major changes: in the first half of 1994, they contracted, but in the second half, they expanded by the « quivalent of over 4% of GDP.

One of the objectives of monetary policy was to reduce interest rates on deposits, with the primary aim being to cut down on the fiscal cost of public-sector debt. Nominal monthly interest rates plunged in the second half of 1994, but subsequently remained at around 4%. Furthermore, fluctuations notwithstanding, real rates were consistently positive. In turn, the decision to authorize the use of government securities to meet reserve requirements enlarged the market for those securities an d thus increased the Central Bank's ability to execute its policy of differentiated interest rates. As i result of these measures, the setting of targets for monetary aggregates became irrelevant aid State-owned banks ran into financial trouble owing to private agents' unwillingness to hold those banks' securities in their portfolios.

3. **The main variables**

a) **Economic activity**

With the introduction of the Real Plan, Brazil's economic reactivation gathered steam in 1994; not only did growth speed up, but it was also more widespread. As a result, output regained the levels that Brazil had attained in the late 1980s.

As early as 1993, expectations regarding economic growth had been changing in the light of the steps taken to open up the economy, the Government's privatization plans and the greater transparency of economic management. Nevertheless, it was the stabilization programme -even when still in its preparatory phase- which sustained the economy's buoyancy and set the stage for a second consecutive year of robust growth.

GDP rose by 5.7% in 1994. Moreover, its growth rate clearly picked up speed as the year went by, since the rate accelerated from 3.5% in the first half of the year to 7.9% in the second. Per capita GDP, meanwhile, was up 3.9%. The upturn in GDP took in all sectors of economic activity. Agricultural and manufacturing output each expanded by around 8%, and services grew by just under 5%. At the subsector level, the communications industry boasted the largest increase (13%), while financial institutions were the only one to experience a decline (-2.8%). The investment rate -which had amounted to 13.7% and 14.5% in 1992 and 1993, respectively- continued on its upward path, reaching the equivalent of 15.4%.

Within the manufacturing sector, notable increases were recorded for mechanical engineering (21%), metallurgy (11%), electrical equipment (19%), and transport equipment (14%). On the other hand, non-durable and semi-durable consumer goods edged up by a scant 2%, with downswings being registered for tobacco (-15%) and pharmaceuticals (-3%).

The utilization of installed capacity topped 80% for the first time in the 1990s and was the main reason for the country's gains in production. The utilization rate approached peak levels for motor vehicles, motor vehicle parts and components, electronics, textile!!, beverages, oil refining, plastics, pulp and paper, and packaging in general.

The level of activity in manufacturing was very uneven. The strong expansion observed in the first quarter of 1994 slackened in the second quarter as a result of the uncertainty engendered by the stabilization plan and the presidential elections. In July, once the Real Plan had been unveiled and the electoral situation had become more clearly defined, the economy became galvanized once again, as all sectors and regions of the country took part in a leactivation that carried it to its highest growth ra te for the year in December. This trend continuée in the first few months of 1995, but subsequently faltered once again.

Domestic demand for consumer durables soared due, in particular, to the demand for household appliances (30%) and motor vehicles (15%). There was also a considerable surge (20%) in demand for capital goods as a consequence of investments in agriculture, transport and the capital goods industry itself, with particularly large increases being observed in the production of tractors (84%), harvesters (42%), and heavy trucks (36%).

In agriculture -another mainstay of economic growth in 1994- there were notable increases in the harvests of levant cotton (18%), sugar cane (19%), cassava (13%) and soybeans (10%). The excellent yields achieved by cotton growers made up for the 32% drop in the acreage planted with this crop in the State of Paraná, Brazil's main cotton-producing region. Larger soybean and kidney bean harvests were attributable to the fact that the amount of land planted with these crops was increased in response to the profitability of these products in the previous season. In the livestock sector, poultry-farming continued to supplant beef cattle at a rapid pace as a consequence of rising beef prices.

b) **Prices, wages and employment**

The 930% increase in the nationwide consumer price index in 1994, as compared to a 2,500% rate in 1993, was concentrated in the first half of the year, when the cumulative rise totalled 760%. The index rose by just 20% in the second half of the year. Excluding July, when the change in currency caused the index to skyrocket, the monthly rate of price increases was just over 2% for the year, and this trend continued in the first half of 1995. The trend in wholesale prices was similar, although foodstuffs climbed much more sharply (1,600%).

For the first time since 1989, the forward momentum of the Brazilian economy led to an increase -albeit a small one (0.7%)- in formal-sector employment, primarily in services and commerce. Moreover, there was a break in the downward trend in formal employment in manufacturing as employment held steady at 1993 levels. This was not true of construction, however, which witnessed a further decline in formal employment. Formal employment levels in large metropolitan areas were unchanged from the preceding year, which indicates that the slight expansion in this variable occurred outside those areas. More specifically, employment in the manufacturing sector of São Paulo continued to decline; set against a background of strong growth, this trend provided evidence of significant progress in the modernization of industrial facilities together with substantial productivity gains.

The expansion of the informal component of the labour market intensified, as the growth rate of around 6% in less formal job categories -self-employed workers and wajje-earners not covered by welfare and labour legislation- was several times higher than the rate for formal job positions. The sectors reporting the most rapid growth in overall employment weie construction and commerce.

Aided by the expansion in employment, average annual rates of open urban unemployment dropped from 5.4 % to 5.1% in 1994. Late in the year, as economic activity mounted, an even further decline : n this rate (to 3.4% in December) brought it down to levels similar to those of the early 1990s

Overall, wages continued to exhibit an upward trend in 1994. The wages of industrial workers in São Paulo were up by about 10% in real terms, partly because several unions managed to win bigger raise: than those stipulated by law when the Real Plan was introduced. There were also signs tfiat the labour income of workers in less formal job categories were higher as well. Consequently, hidden underemployment in metropolitar areas eased slightly, from an annual average of 23.1% to 22.7%. The wages of temporary agricultural workers also rose considerably during 1994.

In contrast, the minimum wag; fell in real terms. The two increases decreed since the Real Plan's inception were not enough to offset the erosion in that wage which occurred in the early months of 1994. During the second half of the year, the real wage levels of work© **s** covered by welfare and labour laws, taken as a group, declined.

c) **The externa] sector**

In the first half of 1994, an agreement was finally reached with creditors regarding the rescheduling of Brazil's external lebt service, and the flow of external resourcss increased significantly, making it possible tc step up the effort (which had been ongoing since 1992) to replenish the country's international reserves. The second six months of the year ' vere notable for the swift rise in imports, while capital flows slowed.

Merchandise exports swelled by] 2% to a total of US$ 43.6 billion and showed a definite tendency to speed up over the course of the year; compared to the same period of the year before, merchandise exports were up 6% in the first six months of 1994 and nearly 15% in the second six. A much sharper increase was seen in merchandise imports (29%), which moved up to almost US$ 33.2 billion; here, too, there was a definite acceleration in this growth trend, since the rate of increase was 17% in the first half of the year and 40% in the second.

All the main export categories expanded in 1994. Semi-manufactured goods achieved the highest growth rate (27%), with sales of US$ 6.9 billion, followed by commodities (18%), with US$ 11.1 billion in sales. Exports of manufactured goods grew at a more moderate -yet steady- pace (6.4%) throughout the year. This category's performance was not as solid as it had been during the two preceding years, mainly because of the steep appreciation of the *real* in the second half of 1994 and the upsurge in domestic demand for exportable products. Nevertheless, external conditions conducive to manufactures were to be found in various markets.

The satisfactory performance turned in by exports of commodities and semi-manufactures was mainly attributable to higher international commodity prices. Sales of coffee (both beans and instant coffee) doubled, reaching US$ 2.56 billion, in large part due to an average increase of 130% in coffee prices on the international market. Total sales of soybean products (17.5 million tons) amounted to US$ 4.1 billion. In addition to higher prices (increases of 8.5% for soybeans and of 31% for soybean oil in bulk), the total sales volume jumped by 22%, thanks to a bumper harvest of 25 million tons. The increase in exports of sugar in its various forms was predominately due to stronger international demand, since India had to purchase 700,000 tons -a third of Brazil's total sales- to cover domestic production losses. The export prices of such mineral products as iron alloys and aluminium were up sharply (24% and 12%, respectively). Sales of orange juice and pulp and paper also received a boost from the international market.

Rising international prices and Brazil's existing capacity to meet demand paved the way for a sizeable expansion of i:s sales to the European Union (19%), which increased its purchases to US$ 11.8 billion and thus consolidated its position as Brazil's leading export market. Exports to the Ur ited States rose by 12%, thereby nearing the USJ 9 billion mark. The countries belonging to ALADI continued to figure as Brazil's second largesl export market, since even though exports to these countries rose by just 8%, they nevertheless amounted to US$ 9.5 billion. Sales to the Asian economies moved up to US$ 7.1 billion owing to lhe effect of the dollar's devaluation in those maikets, especially Japan's. The slow-down in the giowth of exports to members of ALADI reflected the fact that trade flows to these countries are predominantly made up of manufactures, whose export levels sagged in 1994. The drops in sales to Venezuela (-28%) and Chile (-10%) were particularly striking. Exports to the MERCOSUR countri es grew by 10% to about US$ 6 billion. Argentina continued to be the second-largest individual market for Brazilian products (US$ 4.1 billion).

All sectors' import levels showed sizeable gains in 1994, with the exception of fuels, whose purchases expanded by only 6%, As early as the first half of 1994, the implementation of the stabilization plan and mounting domestic demand served to speed up the growth rate for imports, and this trend intensified sharply in the second half of the year. Imports of consumer goods climbed by 66% and imports of raw materials and capital goods rose by 34%. In another notable development, motor vehicle imports jumped 180% in the second half of 1994. Leading suppliers were the industrialized countries in general and the coun ries comprising MERCOSUR. Imports from the European Union grew by 47% while those from the United States rose by 30% and, as a result, the trade surplus with those countries shrank bj over US$ 1.7 billion. Imports from MERCOSUI, countries were up 60% in the case of Uruguay, 38% in the case of Argentina and 29% in the case of Paraguay; consequently, Brazil's surplus with those countries narrowed by US$ 370 billion.

The various tariff reductions and, more particularly, the significant ippreciation of Brazil's new currency set the staj;e for the import boom which occurred in the latter half of 1994.

Imports picked up from a monthly average of US$ 2.3 billion in the first half of the year, to US$ 2.8 billion in September, US$ 3.2 billion in October and US$ 4.6 billion in December. Since monthly exports remained in the range of US$ 3.7 billion in the second half of 1994, by November the country was posting its first monthly deficit in merchandise trade since 1987; in November this financial gap amounted to nearly US$ 500 million, but it then jumped to almost US$ 900 billion in December. Despite the adoption of restrictive measures, such as tariff hikes and the introduction of import quotas on motor vehicles, the merchandise trade balance continued to show a deficit during the first six months of 1995; the cumulative shortfall for this period totalled US$ 4.2 billion and stood in sharp contrast to the US$ 7 billion surplus generated over the same period in 1993.

This turnaround in Brazil's trade position prompted a considerable increase in supply in important sectors of the economy. For example, between August and December the value of monthly imports of motor vehicles escalated from US$ 106 million to US$ 186 million and the average number of imported units leaped from 11,700 per month in the third quarter of 1994 to almost 30,000 in the fourth quarter. Imported motor vehicles trebled their share of apparent consumption in this sector from 6.7% in the first quarter of 1994 to 22.3% in the fourth quarter. Trends in external supply were also noteworthy, with the value of imports of raw materials during the second half of the year standing 28% above the level recorded for the same period in 1993, while the corresponding increase for imports of capital goods totalled 56%.

The upswing in foreign trade spurred the growth of related services. Net outlays for transportation and insurance climbed from US$ 1.8 billion in 1993 to US$ 2.2 billion in 1994. The widening deficit on the services account was also attributable to international travel, which accounted for a net outflow of US$ 1.2 billion, or over 50% more than in 1993.

On the factor services account, net "interest payments amounted to US$ 6.4 billion in 1994, the lowest figure recorded so far in the 1990s. The higher level of international reserves and the regularization of bilateral loan payments owed to Brazil opened the way for a : 13% jump in interest income, for a total sum of US$ 1.7 billion. On the other side of the coin, a reduction in interest payments was made jiossible by the new debt agreement that enterec into effect in May 1994 and by a narrowing olthe spread on Brazilian corporate bonds. Foreign profit remittances totalled US$ 2.5 billicn as a result of both a strong showing by foreign 1 irms operating in Brazil and a drop in the effective exchange rate. Unrequited private transfei payments to Brazil increased to US$ 2.6 billion, which was US$ 900 million more than in 19S3.

The net result of current transactions was a deficit of nearly US$ 1.5 billion, which, though less than 0.5% of GDP, was more than twice the size of the deficit recorded in 19S3. This figure was the outcome of a decline in thi; merchandise surplus and an expansion of trie deficit in non-factor services, although ths was partly offset by a reduction in the delicit in factor services and an upturn in unrequited private transfer payments.

External capital flows went thro ugh two quite distinct stages in 1994. In the first six months of the year, prior to the implementation of the Real Plan, the capital account recorded î net inflow of US$ 7 billion -including US$ 5.7 billion worth of investments in the stock exchang ; and US$ 7.9 billion worth of loans and bond!- and a net outflow of US$ 4.4 billion in short-term capital, with much of this sum corresponding to payments of arrears in debt servia from earlier years. With the advent of the Rial Plan, net capital inflows plunged to just US$. billion, with the stock exchange absorbing US$ 1.6 billion and loans and bonds dwindling to negligible levels. The greater buoyancy of foreign trade and improved price stability contributed to an expansion of credit from suppliers and multilateral organizations, and this lowered the deficit in the first half of 1994 from US$ 1.5 billion to just US$ 270 million. The turnabout in the flow of speculative capital was largely attributable to uncertainty regarding the future course of exchange policy and the continuity of economic policy, together with an appreciable fall in the real exchange rate.

The second quarter of 1994 saw the conclusion of an agreement coveting Brazil's foreign debt with creditor banks and the Paris Club. A total of US$ 46.5 billion in debt was refinanced, including US$ 6.4 billion in arrears on bank debt. The discount obtained via the bond options that were made available amounted to US$ 3.9 billion. Under the agreement with the Paris Club, the refinancing of US$ 42.6 billion worth of debt was arranged. Brazil was obliged to use some US$ 3.1 billion of its own resources in order to put up the necessary guarantees. As of the end of 1994, Brazil's total external debt stood at around US$ 149.5 billion (US$ 119.5 billion in medium- and long-lerm debt and US$ 30 billion in short-term obligations). The level of short-term debt had risen due, in large part, to an upsurge in the lines of credit taken out by commercial banks for the purpose of financing foreign trade operation:;, as the level of such credit trebled in the peri 3d 1992-1994, rising to US$ 28 billion.

COLOMBIA

1. General features of recent trends

In 1994 economic activity continued on the upward path it has followed since the completion of the liberalization programme at the end of 1991. Readily available external financing allowed private consumption to expand greatly, which, combined with the expansion of public spending and gross investment, gave a strong impetus to domestic demand. Thus, the growth rate accelerated to around 6%. The 19% inflation target could not be reached despite the virtual stabilization of the nominal exchange rate. Inflation remained at the same level as in 1993, i.e., around 23%, in what appears to have been a pause in the downward trend in the consumer price index (CPi) since 1991.

The balance-of-payments deficit on current account increased, reaching the equivalent of 5% of GDP, which was similar to the surplus registered in 1991. The Bank of the Republic continued to accumulate reserves in the context of a fluid supply of external resources. Despite the measures adopted to limit short-term capital flows, the real exchange rate dropped for the third year in succession.

Public-sector management produced a surplus, thanks to a substantial rise in current and capital revenues, since total expenditure grew at a robust pace. The new administration which took office in August proposed social-welfare targets which imply greater State hvolvement in economic activity through allocation of public income and expenditure. These targets were formalized through the adoption of the National Development Plan 1994-1998. The Government also added an institutional weapon to its fight against inflation by concluding a partnership agreement with business and labour leaders in December.

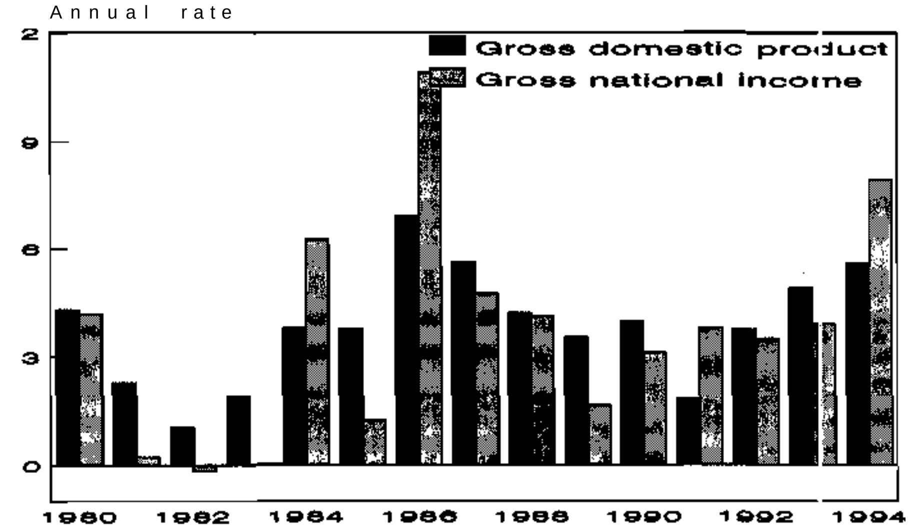
The measures intended to curb domestic demand triggered a substantial rise in interest rates, which continued well into 1995, endangering real economic peiformance as regards both investment financing and the profitability of the export sector. In particular, the measures designed to limit short-term external financing caused the composition of capital flows to shift in favour of long-term investment. For this reason, tie Mexican financial crisis of early 1995 had limited repercussions in Colombia. In the fi :st two weeks of 1995, the Bogotá Stock Exchange index rose 13% in current pesos; the subsequent 20% drop between mid-January and mid-April was due largely to the prevalence of hi¡;h domestic interest rates.

The policy of high interest rates seemed to be slowly cooling down domestic denand during the first half of 1995, by gradually slowing the growth of GDP and inflation.

2. Economic policy

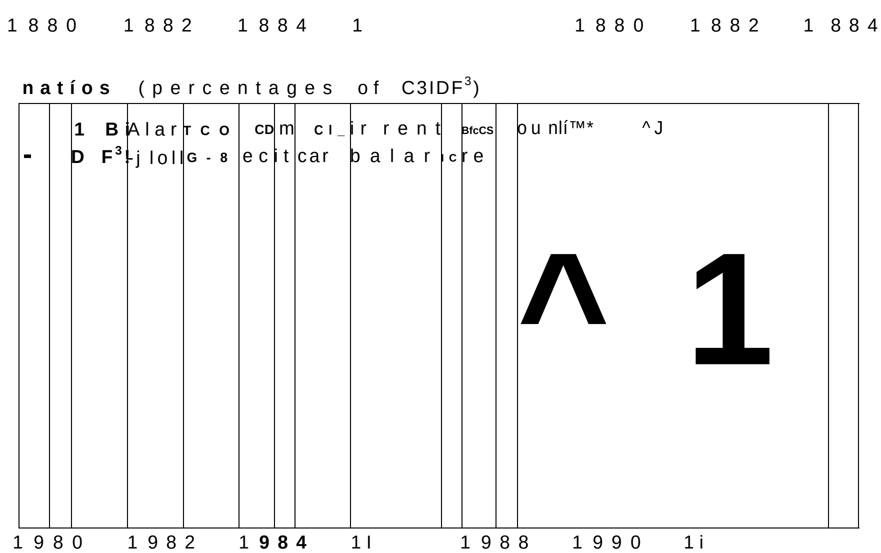
In the context of buoyant domestic demand and abundant external financing, the quest for macroeconomic equilibria rested mainly on the monetary policy applied by the Bank of the Republic, although at the cost of a rise in domestic interest rates. The public sector despite a sharp increase in expenditure, cooperated in this policy by not se îking credit from the monetary authorities and by keeping a portion of the extern; I resources obtained through sales of assets outside the country.

Figure 1
COLOMBIA: MAIN ECONOMIC INDICATORS



Twelve-month variation (%)

Consumer prices



8ouroo: ECLAC, on th« baala of official flgur*-.
»» Of tin*» lsak.lak.nts*» of paymants. [b] Non-flnak.nolak.1.

a) **Fiscal policy**

The year 1994 was in line with the 1990s trend towards the achievement of fiscal balances, despite the increased share of public-sector activity within GDP. The non-financial public sector's total income and expenditure, net of domestic transfers, equalled 33% and 30% of GDP, respectively, as compared with levels of around 24% in 1990 and 29% in 1993. This yielded a surplus of 2.6%, one third of which was generated by the central government.

The substantial increase in expenditure was financed through a comparable growth of current income, equivalent to two percentage points of GDP. Capital inflows increased by a similar amount, exceeding 1,400 billion pesos, through income from privatizations (mainly the Bank of Colombia) and the granting of the concession for the cellular telephone system. The sum of these special revenues was nearly equal to the consolidated public-sector surplus.

Without this income, the central government's accounts would have shown a deficit. Since the resources had been provided by foreign investors, the Government decided to keep them outside the country, together with some of the profits of the National Coffee Fund, so that the flow of foreign exchange would not lead to an expansion of domestic liquidity. Nevertheless, in order to meet its Treasury payments, the Government increased its borrowing, particularly in the domestic market. Abroad, the Government continued to service a portion of its debt through resources obtained from the sale of bonds on more favourable financial terms.

The chief source of regular income, tax receipts, expanded by one third, somewhat more rapidly than nominal GDP, after the still larger increase seen in the preceding year, following the 1992 tax reform. Two of the main sources of revenue, the income tax and the value-added tax (VAT), which were of comparable magnitude, maintained their relative share after the previous year's restructuring; together they accounted for over 80% of tax revenues.

The surge in the national government's total income (50%) made it possible to sustain an increase in public spending of around 40%, in spite of the downturn noted in the second half of the year. The major items of expenditure grew at a rate similar to that of total expenditure, with the exception of interest on the foreign and domestic debt. The interest on the foreign debt continued to display a favourable trend, growing by only 11%, which reflected the country's prepayment policy and improved debt profile, as well as the steady value of the dollar. The interest on the domestic debt, on the other hand, rose substantially (66%), owing to hgher interest rates.

Transfer payments, mostly to decentralized national entities, continued to be the principal item of national government expenditure. The increase in the proportion of current revenues which they absorbed can be attribut ;d to progress in the decentralization process. Total transfer payments, which rose to nearly 8% of GDP, again constituted nearly half of total government expenditure.

Despite the growth of transfer payments, regional and local government accounts were in deficit, as their expenditure rose fas ter than their income. In the remainder of the pub iic sector, the Metro de Medellín and the Sociedac Carbones de Colombia (CARBOCOL) also recorded deficits.

The highest surpluses were seen in the electrical sector and the Empresa Colombiana de Petróleos (ECOPETROL), as well ís the social security fund and the National Coffee Fund. The improved showing of the public services was associated with the rise in service charges and the pressure of demand. The National Coffee Fund's surplus is attributable to the rise in international coffee prices. The social security reform instituted in 1993 was reflected in increased income and contributed to the surplus in the social security account. In 1994 nevf regulations came into force allowing workers under 40 to join private pension funds that compete with the State-owned Social Security Institui e.

The budget estimates contained in the overall economic development plan foresee a comparable growth of public income and expenditure, which will reach 34% of GDP in 1998. The central government accounts, however, show deficit projections for the next few years, which will be offset by a surplus in the rest of the public sector.

Table 1

COLOMBIA: MAIN ECONOMIC INDICATORS

	1987	1988	1989	1990	1991	1992	1993	1994[a]
				Growth rates				
Growth and investment								
Gross domestic product	5.6	4.2	3.5	4.0	1.8	3.8	4.9	5.6
Per capita gross domestic product	3.7	2.3	1.7	2.2	0.1	2.0	3.2	3.9
Gross national income	4.7	4.1	1.6	3.1	3.8	3.5	3.9	7.9
Gross domestic product by sector								
Goods	6.6	3.7	4.6	3.4	1.7	1.2	2.1	3.0
Basic services	4.1	3.7	3.5	3.7	3.4	3.7	5.1	6.9
Other services	5.4	6.0	2.5	3.9	2.3	4.8	6.2	8.5
				Percentages				
Contribution to growth of GDP[c]								
Consumption	3.3	3.9	2.8	1.7	1.2	0.4	4.6	6.2
Government	0.6	1.0	0.6	0.3	0.3	1.1	2.0	2.1
Private	2.8	3.0	2.2	1.4	0.9	-0.8	2.6	4.1
Gross domestic investment	1.5	1.3	-1.3	-0.2	-1.3	5.7	4.9	2.6
Exports	1.2	0.1	1.2	3.2	2.0	1.6	1.6	0.2
Imports	-0.4	-1.1	0.8	-0.7	-0.1	-4.0	-6.2	-3.4
				Percentages of GDP[b]				
Gross domestic investment	16.8	17.5	15.6	14.9	13.3	18.4	22.2	23.4
National saving	17.6	17.0	15.3	15.9	17.9	20.2	18.4	18.7
External saving	-0.8	0.4	0.4	-1.0	-4.6	-1.8	3.8	4.7
				Percentages				
Employment and wages								
Activity rate	57.2	57.9	57.6	58.4	59.5	60.8	60.0	59.7
Open unemployment rate[e]	11.8	11.3	9.9	10.5	8.0	10.2	8.6	8.9
Real minimum wage (Index: 1990=100)	104.7	101.9	102.7	100.0	96.7	95.0	97.6	96.0
				Growth rates				
Prices (December to December)								
Consumer prices	24.0	28.1	26.1	32.4	26.8	25.1	22.6	22.6
Wholesale prices	25.2	29.5	25.6	29.9	23.1	17.9	13.2	20.7
External sector								
Terms of trade (Index: 1990=100)	116.5	111.0	106.4	100.0	103.1	100.8	98.2	113.9
Nominal exchange rate (pesos per dollar)	243	299	383	503	604	681	787	827
Real effective exchange rate (Index: 1990=100)	85.2	86.5	88.8	100.0	101.0	90.0	87.0	75.3
				Millions of dollars				
Balance of payments								
Current account	344	-205	-187	557	2 363	925	-2 081	-2 833
Balance of trade in goods and services	1 324	562	1 195	1 813	2 731	1158	-1638	-1883
Exports	6 816	6 738	7 305	8 658	9 072	9 209	9 901	11867
Imports	5 492	6176	6 110	6 845	6 341	8 051	11539	13 751
Capital account	58	398	621	53	-527	167	2 062	2 998
International reserves (variation)	-106	348	220	668	1 890	1225	207	170
				Percentages				
External debt								
Gross debt (as percentage of GDP)	43.6	43.4	43.4	42.4	40.7	32.5	32.1	30.9
Net interest (on exports)[f]	17.9	17.4	18.2	15.3	12.4	9.8	7.1	8.4

Table 1 (conclusion)

	1987	1988	1989	1990	1991	1992	1993	1994[a]
			Percentages of GDP					
Non-financial public sector								
Current income	22.0	21.6	21.6	23.6	25.1	25.7	27.2	29.3
Current expenditure	17.0	16.6	16.7	16.8	18.2	18.7	18.8	20.7
Saving	5.0	5.0	4.9	6.8	6.9	7.0	8.4	8.6
Capital expenditure	7.2	7.2	6.8	7.4	6.9	7.2	8.1	6.0
Financial balance	-1.9	-2.2	-1.9	-0.6	~	-0.2	0.3	2.6
			Growth rates					
Money and credit								
Banking system monetary balance								
Net international reserves					94.1	29.9	-2.1	-12.7
Domestic credit					-0.4	39.1	54.2	55.6
To the public sector					40.9	-12.9	17.2	14.6
To the private sector					17.1	37.6	.57.8	42.6
Money (Ml) [g]					28.1	39.1	52.8	31.0
Savings and time deposits in local currency					30.7	27.4	45.8	53.5
M2					29.9	30.9	41.7	46.8
			Annual rates					
Real interest rates (annualized)								
On deposits		-0.1	6.3	3.2	8.2	1.4	2.7	6.6
On loans			13.7	9.9	16.6	9.0	: 1.2	15.1
Equivalent interest rate in foreign currency			3.7	4.0	9.8	-1.4	14.8	26.0

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. Based on 1980 dollars at constant prices. [c] Measures the impact of the variation oi each aggregate on the growth of GDP. Derived by multiplying the annual rate of variation of an aggregate by the ratio of that aj gregate to GDP. Percentages of the working-age population. [e] Percentages of the economically active population. Refers to net balance-of-pay ments interest on exports of goods and services. [g] In the hands of the private sector. Interest rate on deposits deflated by the variation in the exchange rate.

Table 2

COLOMBIA: MAIN QUARTERLY ECONOMIC INDICATORS

	1992				1993				1994[a]			
	I	II	III	IV	I	II	III	IV	I	II	III	IV
Consumer prices (12-month variation, *%)*	27.1	28.1	26.8	25.1	24.1	21.4	21.4	22.6	23.4	23.0	22.3	22.6
Real effective exchange rate (Index: 1990=100)	90.4	88.0	91.5	89.9	86.6	85.9	85.0	90.6	78.1	75.4	73.8	74.0
Real interest rate (annualized, %)												
On deposits	-10.8	-7.7	8.9	15.1	-9.5	3.0	7.9	9.4	-12.3	5.4	15.7	17.5
On loans	-5.2	3.1	16.0	22.0	-2.8	11.4	17.4	18.7	-4.8	14.7	25.5	24.8

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures.

b) Monetary **policy**

The programme developed by the monetary authorities at the beginning of 1994 was designed to curb inflation so as to avoid excessive hikes in interest rates and a further real appreciation of the peso. Accordingly, a target range was set for growth in the means of payment (Ml) of between 20% and 28% over the previous year's levels, which was regarded as consistent with the goal of lowering inflation to 19% and ensuring 5% of GDP growth.

In practice, monetary growth, which was faster during the first quarter, exceeded the top of the range during the first 11 months, but had diminished by the end of the year to the point where it met the target.[1] The monetary base registered a similar expansion, lower than in the previous year.

As in 1993, the redemption of maturing exchange certificates became the main factor in the expansion of the monetary base. The amount of these instruments, which had reached a maximum of 1,200 billion pesos in December 1992, dropped from 340 billion pesos in December 1993 to slightly less than 60 billion pesos in December 1994. Adding to the expansionary effect of these debt repayments was the decrease in the amount of other securities issued by the Bank of the Republic in the context of its open market operations (from 1,700 billion pesos in January to 994 billion pesos in December). Only on certain occasions, such as in August, did these operations have a contractionary effect.

The expansion of liquidity in the broad sense (M2) was greater than the growth in the means of payment. At the start of the year, the first aggregate continued to expand at the brisk pace of the previous year, driven by the influx of foreign capital. In the context of a buoyant demand for credit, this liquidity made it possible to maintain the growth of the financial system's loan portfolio seen within the 50% range since the end of the previous year.

Since these trends were incompatible with the inflation target, the Board of Directors of the Bank of the Republic set a limit in March of 2.2% per month (30% per year) on the expansion of the financial system's loan portfolio. At the same time, it established controls on short-term external borrowing. The first measure did not have the full effect intended, and in August the monetary authorities were forced to take action on interest rates, restricting the growth of liquidity through open market operations. Nominal interest rates on deposits, which in the early months of the year had remained at around 25%, climbed to nearly 40% ir November and December, while interest rates on loans were 10% higher. Real interest rates, which had been negative at the outset, rose acco rdingly, to reach averages of 20% and 27%, respectively, in November. The rate of growth of the loan portfolio of financial intermediaries slowed, ending the year at around 45%. Overall expansion of liquidity was 47% in 1994.

c) **Foreign exchange policy**

In January the Bank of the Republic decided to abolish the exchange certificates that had previously been used to delay lhe monetization of foreign exchange earnings. Instead, it established a currency band of *1* % on either side of a reference exchange rate, whose fluctuations formed a "crawling band". Tlie Bank of the Republic undertook to intervene in the market by buying and selling foreign cumncy in order to keep the exchange rate within tlie band.

Despite the measures adopted in 1993 to stem short-term borrowing, the real af prédation of the peso persisted, given the huge influx of foreign capital. This trend was heightened by the expectations of a further appreci ation of the local currency and the widening gap b îtween domestic and foreign interest rates, attributable to current monetary policy. The dollar equivalent of the interest rates on deposits increased gradually to reach a last-quarter average of around 45%, based on the trend in the exchange rate during that period.

The monetary authorities ihen decided to place tighter restrictions on capital inflows by raising the reserve requirements on foreign loans and increasing their time-limits I o five years. The Government also attempted to stem the illegal

The Ml target includes official deposits. Money in the of the private sector was up 31%.

influx of foreign exchange from drug trafficking, in particular, by prohibiting the investment of foreign capital in real estate and real estate companies.

Nevertheless, the supply of foreign currency from all sources showed great buoyancy during 1994. In December, with market exchange rates on the floor of the band, the central bank proceeded to lower it rather than be forced to purchase substantial amouns of foreign exchange. In short, the peso wis devalued by only 3% in 1994, which, in view of the differential in domestic and foreign inflation rates, meant a real appreciation o ' 18%.

3. **Trends in the main variables**

a) **Economic activity**

The accelerated GDP growth seen since 1991 continued in 1994, with an increase of nearly 6%. This rate meant an increase in per capita GDP of around 4%, the highest since 1986. Domestic income rose approximately 8%, bolstered by the improvement in the terms of trade.

As in the preceding two years, domestic demand, which expanded by almost 9%, stimulated the growth of GDP. External demand did not play a significant role, since the volume of exports increased by barely 1%.

Demand was fuelled mainly by private consumption, which was up 6%. Increased capital formation in the public sector and among private investors was also a contributing factor. Public consumption, which increased by 17%, became a significant motor of the economy, although it accounted for a smaller share of total demand.

Total investment was up 12%, after two years of brisk recovery, thereby accounting for more than 23% of GDP. Both the private sector and the public sector, but especially the former, contributed to the investment growth.

Output lagged behind the growth of aggregate demand, so that demand had to be met partially through a substantial expansion in the volume of imports (16%). The excess of expenditure over income led to a resulting balance-of-payments deficit on current account. This was easily covered by external savings, which financed one fifth of domestic investment.

Non-tradables, particularly construction and services, were again the sectors displaying the greatest buoyancy. The growth of construction (12%), which had been booming since 1992, was accompanied by a spectacular surge (of between 50% and 56% annually for most of the year) in the investment portfolio of savings and loan associations -one of the highesi growth rates registered by all financial intermediaries.

A similar trend, indicative oj the boom in retail commerce, was seen in the portfolio of commercial financing companies. However, vehicle sales returned to lower levels after the spectacular gains of the previous year. In contrast, sales of furniture aid household appliances continued to climb rapidly. Other services also posted favourable results, with total growth of nearly 9%. The largest increases were in financial and government services, with the latter accounting for nearly one tenth of GDP.

Industry as a whole grew mois slowly than total output. Coffee-threshing contacted by 7%, while other manufacturing expandi ;d by less than 5%. The results were highly dissimilar in various industrial branches, with few exceptions, the patterns seen in 1993 were repealed. The push from construction and services was transferred to the related industries; wooden funiture, plastic products, metallic products (especially those made of iron and steel), pottery *i* rticles, paper products and printing registered double-digit growth. The traditional industries, 1 owever, such as clothing, tobacco, rubber produc ts and leather goods, remained depressed.

Agricultural output increased only slightly (2%) after the 1993 upturn. The coffee harvest continued to fall, this time by 11%. Growth faltered in both annual and permanent crops, as well as in the livestock sector. A¡ in previous years, poultry farming turned in the best performance. In the last quarter sf 1994, the Government adopted an agricultural modernization programme whose implications reach beyond the economic and sccial spheres, since Colombia's security and violence problems have a significant impact on rural areas.

Mining remained nearly stagnant, on the whole, as did oil drilling, since the increased production expected from the Cuisiana oilfields, which are expected to give a strong impetus to sectoral output, was delayed. Precious minerals suffered a sharp drop in production, while, coal and iron ore recovered somewhat from the previous year's decline.

b) **Prices, wages and employment**

The rise of nearly 23% in consumer prices was similar to the 1993 figure and higher than the official target (19%). The upward trend in inflation seen since the previous August, fuelled by the surge in demand, was halted only in June. Thus, in the second half of 1994, the consumer price index (CPi) stabilized, as a result of more restrictive monetary policies applied by the Bank of the Republic and the stability of the nominal exchange rate.

Moreover, various groups of products showed more uniform trends in prices. In particular, the food price index, which had lagged considerably behind the inflation rate in 1993, shared in the overall rise in 1994, thus regaining some ground. The largest increases were seen in services (health and education) and housing. In the case of public services, prices and rates rose 27% on average.

If services are excluded, the producer price index (PPI) posted a smaller increase, of less than 21%. This result is in line with the clear trend towards uniformity among various groups of goods, since the PPI had risen only 13% in 1993. The largest increase in 1994 was influenced by the recovery of agricultural prices.

While the course of the exchange rate helped to slow the CPi, the real appreciation of the peso precisely reflected the shift in the relative prices of tradable and non-tradable goods to the advantage of non-tradables. The producer prices of imported goods rose barely 10%, as compared with the 22% increase in the prices of domestic products.

In order to limit the impact of the inertial aspects of inflation, which influence current expectations and indexation practices, the Government and labour and business sectors signed the Social Pact on Productivity, Prices and Wages in December. Its aim is to reduce inflation gradually, setting an 18% target for 1995. The Government committed itself to a fiscal policy which, in keeping with this goal, foresees a moderate fiscal surplus and the management of public-service rates.

In view of the practice of pegging workers' wages to the previous year's inflation, the fact that inflation levels in 1994 were similar to those of 1993 meant that the average real wages of industrial workers were only marginally higher than in 1993, remaining at 4% nbove the 1990 level. The real minimum wage, he wever, was 4% lower than at the beginning of the 1990s and almost 2% lower than in 1993. Employment did not vary significantly during the year, so that the unemployment rate was similar to what it had been the year before, i.e., around 9%.

c) **The external sector**

The gap between the growth rates of real domestic spending and outpu; widened the current-account deficit to more than US$ 2.8 billion, or almost 5% of GDP. The current account has deteriorated steadily since 1991, when it showed a surplus in the same percentage after the initial deregulation measures.

Although expenditure exceeded current income, the Bank of the Republic accumulated net reserves of more than US$ 13(l million during the year, so that by the end of 1994 net reserves totalled over US$ 8 billion. This was due to the inflow, for the second year running, of large amounts of foreign capital which, in net terms, exceeded the amount recorded in 1993 by over US$ 1 billion, and bordering on a record figure of US$ 3 billion. The build-up of foreign exchange could have been much greater, had it not been for the Government's decision to keep a significant percentage of its foreign-currency resources, stemming from privatizations, the granting of the cellular telephony concession and coffee exports, outside the country. If this capital outflow is excluded, the balance of payments actually shows a surplus of some JS$ 1.5 billion.

The deterioration of the current account covered the trade balance for both goods and services. The trade deficit was up from more than US$ 1.6 billion in 1993 to nearly US$ 1.9 billion in 1994. Exports of goods rose 15% and imports by 20%. The export performance was marked by the coffee boom, with producers benefiting from the rise in international prices, which bolstered revenues by nearly US$ 1 billion. In contrast, the value of oil exports contracted by 11%, owing to the drop in both physical volumes and prices. Pending the expansion of crude oil shipments from the Cuisiana oilfields, oil slipped below coffee as the leading Colombian export in 1994.

Despite the real appreciation of the peso, non-traditional exports (i.e., excluding oil, coffee, coal and ferronickel), which accounted for more than half the total, were up 13%. Among industrial exports, beverages, certain chemical products, iron ore and steel, some non-metallic mineral products and clay, pottery and other china turned in a strong performance. Textile and clothing exports declined again, this time by 2%.

The three major import categories contributed to the overall boom. Capital goods, driven by investment, showed an outstanding increase. The contribution made by this group of imports, which has risen in recent years, climbed to around 40%, placing it almost on a par with intermediate goods. Consumer goods accounted for the remainder of the increase in imports.

The primary factor in the deterioration of the trade balance for services was the doubling of the amount of interest paid by the private sector, which demonstrated the rapidity with which private debt has increased recently. On the other hand, the substantial increase in dividends from Colombian investments abroad (which, while still relatively modest, grew from an average of US$ 20 million in 1988-1990 to US$ 66 million in 1993 and to US$ 180 million in 1994) testifies to the expansion of such investments in recent years.

The expansion of net capital inflows by nearly US$ 1 billion occurred simultaneously with changes in their composition. While short-term capital flows had exceeded lonj;-term ones in 1993, long-term capital took the lead in 1994, verging on US$ 3.8 billion net, as ;ompared with US$ 900 million in the previous 3 ear.

Two main factors account for this change. First, foreign direct investment w«s up by almost US$ 1 billion, reaching nearly Uii$ 2 billion, or more than three percentage points of GDP. Colombia received abundant resources for the development of the Cuisiana oilfk Ids, as well as from privatizations and the grunting of the cellular telephony concession.

Secondly, the steps taken by tli e Bank of the Republic since 1993 to limit short-term, speculative capital flows transformed private borrowing patterns. While short-term borrowing fell by half (from US$ 1.1 billion ii 11993 to US$ 570 million in 1994), long-term borrowing tripled (from US$ 800 million to UÍ1$ 2.6 billion). At the same time, the public sector continued to reduce its foreign debt, this time jy more than US$ 800 million (mainly long-term debt). A large share of this decrease was linanced with resources from bond issues in the international markets, mainly in the United Statt s. The public sector was responsible for a net outflow of short-term capital amounting to more than US$ 1.1 billion, by leaving resources obtained from the sale of enterprises outside the country, so as to contribute to the achievement of the monetary and foreign-exchange targets.

The total private-sector debt, which had been less than US$ 5 billion in 1993, incnased to US$ 8 billion, an amount equal to the tota 1 net reserves held by the Bank of the Republic. The public-sector debt contracted slightly, so that the country's total external debt rose for the second year running, from US$ 18.4 billón to nearly US$ 21.3 billion. Debt-service payments, including both amortizations and interest payments, also increased, to accourt for 43% of exports of goods and services.

COSTA RICA

1. General features of recent trends

In 1994 the Costa Rican economy expanded significantly, by over 4%, although more slowly than in the previous two years. Despite the growth of aggregate output and a decrease in the foreign trade deficit, signs of macroeconomic disequilibria were perceived during the year. These consisted mainly of a massive fiscal imbalance, the acceleration of domestic price increases to an annual 20%, and the persistence of a high deficit on the current account of the balance of payments.

Economic performance was influenced by the electoral climate and the financial setback resulting from the failure of a large State bank. In the external seel or, while the terms of trade improved, espec: ally because of the sharp rise in coffee prices, the country faced a less promising situation vith regard to financing. This caused a decrease in capital inflows, so that a significant portion of the current-account gap was covered at the cost of a drop in reserves. While lotal exports increased at a healthy pace, Cost i Rican trade developed in an environment of harsher competition; in looking towards t tie future, the challenge of finding ways to stimulate the economy's linkages with the glosai economy wasposed.

2. Economic policy

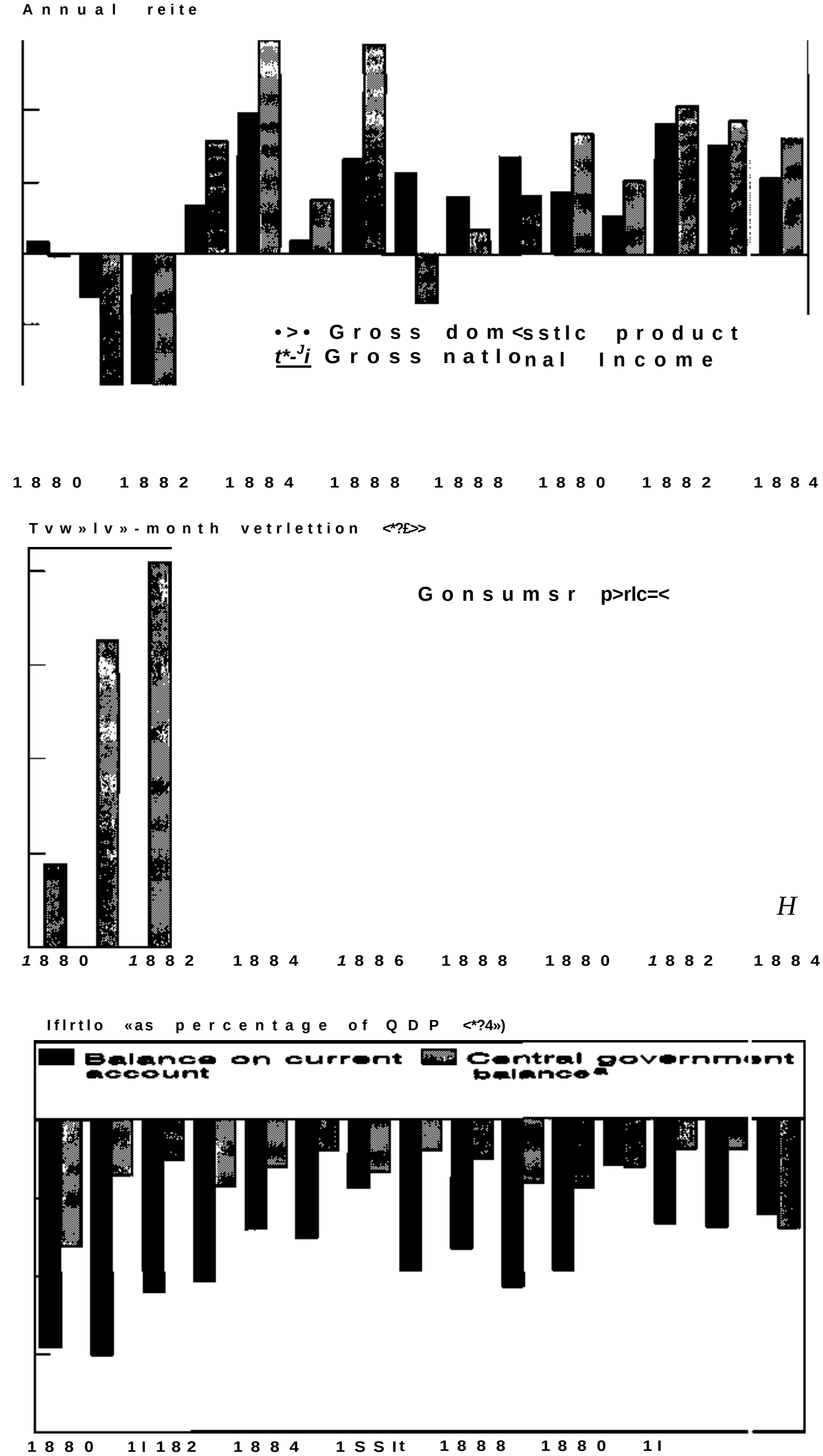
In 1993 fiscal policy generated a financial surplus in the consolidated public sector and the inflation rate was brought down to an annual 1%. However, these results were tenuous; the inflation drop, in particular, had been supported in part by maintaining the nominal exchange rate and postponing adjustments in public-service rates. In fact, the rate of variation in prices doubled in 1994, while government accounts posted a sharp imbalance.

Fiscal policy was characterized by a rapid increase in public spending linked to special outlays during the electoral period and to the growing burden of the domestic debt that had been accumulating. The need to resort to local lending sources intensified, owing to the postponement of the third stage of the Structural Adjustment- Lending programme (SAL ill) agreed on with the World Bank, which meant that the external funds envisaged in the programme would not be forthcoming.

The Government's high financing needs had a major influence on monetary management and the behaviour of credit markets. The money supply grew substantially; *i* particular contribution in that regard wis made by public-sector funding requirements and the injection of resources to bolster the i ;ommitments of the Banco Anglo-Costarricense, whose failure was precipitated by losses in foreign securities holdings. Given the stimuli which tended to expand the monetary mass, the authorities utilized bond issues to restrain the liquidity increase generated. Thus, a portion of the funds which would otherwise have been diverted to private financing were absorbed* and probably stimulated a rise in the interest rate, Meanwhile, the costs of domestic debt service became a major element of pressure on fiscal policy.

Exchange-rate policy continued to evolve within a system of managed flexibility. The dollar price slippage was a little mc re rapid than in 1993, and it accelerated somtwhat in the

Figure 1
COSTA RICA: MAIN ECONOMIC INDICATORS



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second half, owing, in particular, to greater difficulties in obtaining external financing. The rise in the exchange rate during 1994 was far smaller than the increase in domestic prices; however, the average real effective exchange rate for 1994 was slightly higher than it had been in the previous year.

a) **Fiscal policy**

The central Government deficit grew to 7% of the gross domestic product (GDP), after having been under 2% the year before. The pronounced rise in the deficit was attributable to the increase of 54% in current expenditure (around 30% in real terms), while income rose by only 16%.

Fiscal management in 1994 was expansionary, especially in the area of wages and purchases of goods and services. Moreover, the amount of transfers to the private sector increased sharply for such items as pensions, which rose by 47%, and tax-credit certificates (74%). In addition, interest expenditure increased by 60%, reflecting the higher financial burden created by the sale of securities to cover spending. In an exceptional case, transfers to the Banco Anglo-Costarricense also increased, representing over 9% of current government expenditure. However, even though such outlays were not registered, current expenditure appears to have increased by nearly 40%, in other words, much more than prices.

The marked increase in the fiscal gap revealed the feeble effect of the recent legislative changes aimed at overcoming the rigidity of central Government expenditure, especially as regards pensions and tax-credit certificates. In the case of pensions, following the adoption of the new Pensions Act, amendments were introduced which maintained the special schemes for some groups of pensioners. As regards tax-credit certificates, extending the time span of benefits (while reducing the annual amounts) postponed the impact on the public exchequer. Domestic debt constituted another important source of pressure on spending; debt service climbed to 17% of current outlays. The value of bonds in circulation, including those of the financial and non-financial public sector, increased by 50% from 1993 to 1994, coming to represent 27% of GDP. Two thirds of this mass of bonds emanated from the central Government and non-financial public institutions, while the remainder were issued by State commercial banks a id the Central Bank of Costa Rica. While extern U public debt service had traditionally involved complex negotiations with creditors, the gradual replacement of external debt by comestic debt proved financially onerous.

Government investment increajed by nearly 40% in 1994. Despite this strong upturn, the funds allocated to capital formation decreased as a share of total expenditure. Thî amount of investment by the consolidated public sector as a whole rose to 4.1% of GDP, a somewhat higher figure than in previous years. In general, the shortage of funding sources and the rigidity of current expenditure have affected t le volume of public investment, and this has limited the supply of infrastructural services.

Central Government tax revenue as a share of GDP decreased by around 0.8% h 1994. Tax receipts were affected by the decrease in the sales tax from 11% to 10%, the lowering of import tariffs on raw materials and the slower growth of imports. In addition, the collection of a tax on coffee exports when the international price exceeded US$ 0.80 per pound was suspended by a judicial decision, and this deprived the Government of a major source of revenue. Moreover, income tax receipts, which had climbed steeply the year before owing to provisions which eliminated exemptions and expanded the tax base, increased more slowly.

In contrast to the situation in previous years, public enterprises did not help to offset the financial imbalance in central Government accounts. The Costa Rican Electricity Institute required financing worth 11.66 bil ion colones (as compared with a surplus of 7.012 billion colones in 1993) as a result of the large investments it made in modernizing the telephone system (chiefly, the development of cellular telephony) and, to a lesser extent, in speeding up the construction of elec rical plants. The Institute's costs were financed, in part, through sales abroad of bonds worth US$ 50 million. The deficit of the Costa Rica a Petroleum Refinery (3.7 billion colones, as against a surplus of nearly 7 billion colones in 1993) was due

Table 1
COSTA RICA: MAIN ECONOMIC INDICATORS

	1987	1988	1989	1990	1991	1992	1993	1994[a]
				Growth rates				
Growth and investment								
Gross domestic product	4.5	**3.2**	5.5	3.4	2.1	7.3	6.1	4.3
Per capita gross domestic product	1.6	0.4	2.6	0.7	-0.4	4.6	3.5	1.9
Gross national income	-2.7	**1.4**	3.3	6.7	4.1	8.3	7.5	6.5
Gross domestic product by sector								
Goods	4.5	**3.1**	6.1	2.1	3.1	6.6	5.4	3.5
Basic services	8.4	6.2	7.8	6.6	3.5	11.2	9.0	7.5
Other services	4.0	2.9	4.6	4.1	1.1	7.2	6.1	4.4
				Percentages				
Contribution to growth of GDP [c]								
Consumption	3.6	1.0	4.7	4.8	-2.3	7.7	6.1	4.6
Government	0.4	0.5	0.6	0.3	-0.1	0.4	0.9	0.4
Private	3.3	**0.6**	4.1	4.4	-2.2	7.3	5.2	4.2
Gross domestic investment	0.8	**-1.7**	2.2	0.8	-3.0	6.1	2.5	0.5
Exports	7.1	**3.6**	6.1	4.1	4.4	8.4	8.0	2.2
Imports	-7.0	0.2	-7.5	-6.3	3.1	-15.0	-10.5	-3.0
				Percentages of GDP				
Gross domestic investment	23.9	21.6	22.5	22.6	19.1	23.5	24.5	24.0
National saving	11.5	11.4	9.1	9.8	15.5	14.2	14.1	14.8
External saving	12.4	10.2	13.4	12.8	3.7	9.3	10.4	9.2
				Percentages				
Employment and wages								
Activity rate	94.4	**94.5**	96.2	95.4	94.5	96.0	95.9	95.8
Open unemployment rate [e]	5.6	**5.5**	3.8	4.6	5.5	4.1	4.1	4.2
Real minimum wage (lower level) (Index: 1990=100)	95.1	95.1	99.1	100.0	92.8	92.5	92.7	93.6
				Growth rates				
Prices (December to December)								
National consumer prices	16.4	25.3	10.0	27.3	25.3	17.0	9.0	19.9
Wholesale prices	10.9	19.7	10.7	27.9	22.3	12.7	6.6	
Industrial producer prices						10.4	6.2	19.9
External sector								
Terms of trade (Index: 1990=100)	107.0	105.4	101.7	100.0	101.8	103.4	105.8	109.0
Nominal exchange rate (Colones per dollar)	62.8	75.8	81.5	91.6	122.4	134.5	142.2	157.1
Real effective exchange rate (Index: 1990=100)	99.6	104.0	98.0	100.0	108.3	103.0	100.7	101.3
				Millions of dollars				
Balance of payments								
Current account	-444	-394	-567	-561	-167	-455	-537	-515
Balance of trade in goods and services	-177	-75	-217	-364	-22	-320	-409	-384
Exports	1451	1620	1 841	1974	2 200	2 592	2 994	3 332
Imports	1628	1695	2 059	2 338	2 222	2 913	3 403	3 716
Capital account	481	636	713	364	515	631	478	295
International reserves (variation)	11	226	150	-197	352	181	-61	-220
				Percentages				
External debt								
Public debt (as percentage of GDP)	82.1	80.5	72.0	54.9	57.1	48.2	40.6	38.4
Net interest (on exports)	18.7	19.6	17.8	9.5	5.7	5.0	4.7	3.9

Table 1 (conclusion)

	1987	1988	1989	1990	1991	1992	1993	1994[a]
				Percentages of GDP				
Non-financial public sector								
Current income	26.0	26.7	26.7	26.1	27.6	28.2	28.2	25.9
Current expenditure	21.3	21.8	23.6	23.9	23.7	22.3	22.2	26.6
Saving	4.7	4.9	3.2	2.2	3.9	5.9	6.0	-0.7
Capital expenditure	4.9	4.9	5.7	4.8	4.1	5.4	5.4	6.1
Financial balance	-0.2	0.1	-2.5	-2.5	-0.1	0.7	0.6	-6.9
Domestic financing	0.5	0.3	2.1	2.2	-1.2	-1.3	0.3	6.1
External financing	0.7	-0.2	0.4	0.3	1.3	0.6	-0.9	0.8
				Growth rates				
Money and credit								
Banking system monetary balance								
Net international reserves	18.6	83.4	29.2	-19.8	156.5	23.0	4.9	-1.6
Domestic credit					-6.7	40.4	28.2	27.5
To the public sector					4.9	-4.3	2.7	16.1
To the private sector					8.9	48.0	36.1	18.5
Money (Ml)	4 6	21.6	18.2	7.5	29.0	36.0	7.8	27.0
Savings and time deposits in national currency					19.3	47.1	38.2	-4.9
M2					24.6	40.8	21.6	10.5
Dollar deposits					71.7	15.3	7.3	25.7
				Annual rates				
Real interest rates (yearly average)								
On deposits		-7.7	5.2	-4.9	1.5	-1.0	7.3	-1.8
On loans		3.2	17.6	4.0	10.8	9.8	19.3	11.0
Equivalent interest rate in foreign currency [g]		-0.3	9.2	-0.4	-2.8	15.1	6.4	7.9

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Based on 1980 dollars at constant prices. [c] Measures the impact of the variation < if each aggregate on the variation of output. Derived by multiplying the annual rate of variation of an aggregate by the ratio of hat aggregate as a percentage of GDP. Percentages of the economically active population. [e] Percentages of the workinj :-age popul ation. In 1993 the wholesale price index was discontinued and replaced by an industrial producer price index. ; Interest rate on deposits deflated by the variation in the exchange rate.

Table 2
COSTA RICA: MAIN QUARTERLY INDICATORS

	1992				1993				1994"			
			III	IV		II	**III**	IV		II	III	IV
Consumer prices (12-month variation, %)	26.4	23.4	19.0	17.0	10.2	9.3	8.9	9.0	11.4	12.1	16.3	19.9
Real exchange rate (Index: 1990=100)	107.1	99.0	104.1	101.8	100.4	99.5	100.0	102.7	102.5	101.6	101.0	100.1
Real interest rate (annualized, %)												
On deposits	-11.0	-4.6	7.3	4.4	10.3	-0.7	12.9	6.8	3.0	0.6	-3.7	-7.1
On loans [c]	-0.2	7.2	18.0	14.2	21.2	11.0	25.7	19.5	15.6	13.6	9.5	5.2

Source: ECLAC, on the basis of official figures.
* Preliminary figures. [b] Deposits (180 days). [c] Short-term.

mainly to its payment of overdue taxes to the Government (during the second half) and to slow price adjustments. Meanwhile, the Costa Rican Development Corporation contributed resources from the sale of the State enterprise Cementos del Pacífico.

The new Government that took office in mid-1994 put forward various fiscal reforms. As regards expenditure, consideration was given to the restructuring of ministries, staff cuts and changes in the pension system. In the tax area, far-reaching measures were proposed to the legislature, including modernizing the management of the tax and tariff system and imposing harsher penalties for evasion. Furthermore, proposals were made for applying a tax of 1% on corporate assets, which could be credited to income tax, limiting interest deductions and updating presumptive income. The Government also planned to establish a unified corporate income tax rate of 30% and to create new brackets for wages and pensions with a maximum marginal rate of 30%; the tax package also included a rise in the sales tax from 10% to 15%, a tax on motor vehicle ownership and the elimination of various taxes of lesser scope. Through these measures, the authorities sought to strengthen government revenue and facilitate the signing of agreements with multilateral lending institutions; however, the procedure for parliamentary approval of the tax reforms ran into difficulties.

b) **Monetary policy**

Monetary management was limited by the massive fiscal deficit, and by uncertain public expectations, which were expressed in a growing dollarization of financial investments and a shortening of the time span on deposits.

The quantity of means of payment grew by 27%, in other words, much more rapidly than in the previous year (8%). Primary money creation was attributable solely to the Central Bank's domestic credit operations, since the movement of net international reserves had a contractionary effect. The expansion of the monetary base, which had significant momentum despite the higher volume of regulatory securities, was fostered by the Central Bank's progress in meeting the liabilities oí the Banco Anglo-Costarricense. In addition, loans to the central Government grew sharply; this was partially offset by the sustained lowering of credit to other official institutions.

The transactions of the banking system as a whole also showed a more rapid ii icrease in credit to the public sector, while the increase in loans to the private sector slowed markedly; these, at any rate, rose slightly less than prices. The behaviour of deposit demand was marked by a change in the composition of deposits. One notable phenomenon was the none inal drop of 5% in the mass of time deposits in local currency, while, at the same time, deposits in foreign currency grew by over 25%. The marked shift in public preferences towards foreign-exchange assets probably stemmed from :oncerns about the evolution of the exchange rate and uncertainty factors associated wii h the change of government and the failure of the Banco Anglo-Costarricense. Moreover, it is likely that there was a continuing redistribution of deposits from State banks, whose interest iates on deposits were lower than the system aveiages, to private banks.

Bank interest rates did not change significantly during 1994; they remained at higher nominal levels than the previous year's average. Given the acceleration of prices, this meant that as an annual average, he State banks' real rates on deposits were negative, while the real rates on loans diminished as compared with the previous extremely high levels. In any case, the yields on deposits (and especially on loans) amply exceeded the monetary depreciation rate; thus, the holding of assets in local currency implied a demand for significant cover premiums.

Towards the end of the yeai the authorities adopted a number of measures to control monetary expansion. Chief among them was the graduated rise in the legal reseive requirement from 1 November onward. The percentages fluctuated between 43% for more liquid deposits and a minimum of 10% for time deposits of over six months, for all banks with the exception of those which purchased monetary stabilization certificates. The higher reserve requirements had an impact on the spread between interest rates on loans and deposits, which was already large owing to the magnitude of brokerage costs.

The Government's objectives included improving banking services and reducing the Central Bank's losses. In keeping with such aims, proposals were submitted for modernizing and expanding the services provided liy State banks. The authorities also proposed the strengthening of bank supervision, keeping in mind, in particular, the recent failure of the Banco Anglo-Costarricense.

3. **Trends in the main variables**

a) **Economic activity**

The gross domestic product grew by over 4%, i.e., at a rate similar to the average for the past eight years, but lower than the one registered in the biennium 1992-1993. Apparently, the slowdown in the economy was more pronounced in the second half of 1994, given the policies aimed at controlling expenditure and the greater shortage of external resources. As regards aggregate demand, the most expansive component in 1994 turned out to be consumption, which grew by nearly 6%. Following two years of accelerated growth, fixed investment rose only moderately (4%); none the less, capital formation as a percentage of GDP remained at higher levels than in the recent past. Meanwhile, the increase in the volume of exports and imports of goods and services was much smaller than in the previous year; in 1994, foreign trade flows evolved at a pace comparable to that of aggregate activity.

While the domestic saving ratio shrank, owing to the growth of consumption at a faster rate than GDP, the terms of trade improved and factor payments abroad diminished somewhat. Accordingly, the national saving rate was close to 15% of GDP, higher than in 1993, but still far from the magnitude of resources needed to finance investment. Thus, external saving climbed to over 9% of GDP, as compared with over 10% in 1993: in other words, it still represented around 40% of total saving.

On the supply side for goods and services, the GDP increase was distributed among the main branches of activity. In general, moderate growth rates were seen in the various sectors, with the exception of basic services, which expanded by over 7%, well above the average.

The agricultural sector maintained a growth rate of close to 3%, lower than aggregate GDP. Among the factors which slowed the expansion of the sector were the shortage of credit, adjustment to the process of ojening up to foreign markets and the elimination of guaranteed prices, which were fre quently fixed above those on the international market. The National Production Council, which was in charge of marketing basic produci s, reduced its size and redefined its tasks; it suspended grain purchases and price stabilization Of «rations, thus mitigating the losses which such operations had caused to the Central Bank.

In 1994 the production oí traditional agricultural export goods did not reflect the changes taking place in the international economic climate. Thus, the coffer, harvest was smaller; low external prices had discouraged coffee-growing until May, wher a recovery occurred. In addition, yields were affected by weather conditions. The price stampede in the second half -from July to September, prices exceeded US$ 2 per pound, as compared with US$ 0.50 per pound at the beginning of the period- was not immediately reflected in producers' incomes, since a large share of the harvest had been sold ahead of time it low prices. Meanwhile, the sown area for bananas expanded from 49,000 to 52,000 hectares, notwithstanding the obstacles created by the European Union's unilateral setting of quotas, which, rone the less, were insufficient to depress average annual prices. Output also increased, although more slowly than in previous years (3%, is compared with 10% in 1993 and 12% in 1992) The drop in sugar cane production was largely associated with uncertainty over the possibilities for entering the United States preferential market.

Among agricultural products far domestic consumption, there was a notable recwery in rice and bean crops. In the case of rice production continued to be concentrated in holdings with entrepreneurial management and in irrigated areas; in such areas, which continued to expand, it is possible to obtain three harvests a year, as compared with only one in areas with abundant rainfall. Bean production maintained its profit levels in relation to other grains; this product cannot easily be replaced with imports because of consumer preferences. On the other hand, the supply of soft maize, whose sown area was reduced from 23,600 hectares during the 1992-1993 growing season to 17,500 hectares in 1994-1995, deteriorated, as did that of sorghum.

While cattle slaughtering increased substantially, this did not reflect a parallel growth of livestock-raising, since herds continued to decline, but rather the fact that a growing proportion of the slaughter represented animals imported from Nicaragua. Meanwhile, the outlook for milk production was favourable, as a high tariff had been established during the Uruguay Round of the General Agreement on Tariffs and Trade (GATT) talks; milk and dairy products would thus be protected in the domestic market, while at the same time, favourable exporting opportunities existed.

The market for non-traditional agricultural export goods has become more uncertain, and production of some items has slowed, while that of others, has continued to expand. In some cases, crops for domestic consumption, particularly maize, were displaced by other crops for export, such as cassava and other tubers. Certain products, such as melons, were affected by the preferences granted by the United States to purchases within the area covered by the North American Free Trade Agreement (NAFTA). However, foreign investors continued to undertake new types of agriculture (particularly banana companies, which sought alternative markets), thus increasing their presence in the production of non-traditional goods.

Manufacturing registered an expansion of 4%, attributable particularly to dynamic growth in the first half (6%), since there was a definite slowdown in the second half (3%). Despite trade liberalization and the gradual elimination of subsidies, industry has managed to retain its share of GDP, which was somewhat higher than in 1980. In 1992 and 1993 industry had been encouraged by an expansion of domestic and foreign demand (due, in part, to :he recovery of the Central American market) and better macroeconomic conditions, which reduced the uncertainty regarding investment and production decisions. These conditions chtnged in 1994, when it became more difficult to obtain local credit, and external financing contracted. Moreover, the decrease in the real exchange rate over the year affected the sectors dependent on international markets, while the reduction of raw materials tariffs from 10% to 5% during the period from January to April had the opposite effect.

The manufacturing industry experimented with various changes driven, in p irticular, by the signing of new international trade agreements, some of which were already in force (the free trade agreement with Mexico), vhile others had yet to emerge (an agreement providing benefits parallel to those of NAFTA). For example, there were various operations which internationalized the capital of large enterprise!;; Costa Rican foodstuffs, beverages and tobacco firms were bought by Mexican firms, which, encouraged by the free trade agreement between Costa Rica and Mexico, envisaged a potential expansion of the export mar cet to include Central America. There was also an increase in associations of Costa Rican and foreign investors aimed at promoting joint ventures for the marketing of foreign brand: in the country and abroad. Funds were also invested in expanding production capacity for such items as confectionery, either in order to take advantage of greater access to the Mexican market (which, in turn, would îllocate a larger proportion of its supply to th< United States market through NAFTA), or in preparation for the potential signing of an agreement providing benefits parallel to those of NAFI A, which would open up the United States market.

Sectoral performance in 1994 was very mixed. The chemical products and rubber industries, stimulated mainly by Central American demand, grew rapidly (21%). The publishing and printing industry also expanded appreciably (8%). The recovery of banana exports from the second quarter onward, and the increased output of other non-traditional agricultural products, such as pineapples, which require cardboard packaging, partially explained this behaviour. The metallurgical industry, driven by external demand, maintained its dynamic growth, especially in electrical machinery. On the other hand, other activities, such as textiles, leather goods and footwear, were harmed by imports. Moreover, some maquiladora industries, especially confectionery, were transferred to other countries in the region in which wages were lower. However, others (for example, electronics) expanded their production capacity. In any case, in aggregate terms, maquila exports have remained virtually constant since 1992.

The construction sector behaved as it had on other occasions when a change of command was imminent; in general, housing construction tends to be concentrated towards the end of presidential terms, and this reduces the funding available when a new Government takes office. Other factors were lesser fluidity of credit and a slowdown in economic activity in the second half of 1994. However, tourism and commerce helped to stabilize the demand for buildings; construction also received a higher percentage of total credit. The overall effect of these factors was an increase in sectoral GDP of slightly over 4%.

The output of basic services grew significantly. A factor contributing to the large increase in electricity generation was the start-up of Miravalles, the first geothermal plant, with a capacity of 55,000 MW. The outlook for increasing the energy supply expanded owing to the approval by the Legislative Assembly of loans from the Inter-American Development Bank (IDB) for execution of the third phase of the electrical development programme. In that phase, financial support would be provided for a 177-MW hydroelectric project, expansion of the geothermal plant and a 20-MW wind energy project.

b) **Prices, wages and employment**

The inflation rate hovered at around 20%, amply exceeding the forecasts made at the start of the period. The same thing happened to the industrial producer price index. The rise in consumer prices intensified in the fourth quarter, when the average monthly rate of variation was nearly 2%.

This evolution probably came : n response to a number of stimuli. The rapid increase in total spending in previous years may ha' re had belated effects, exerting pressure on the supply capacity, especially in sectors with fewer linkages to the international market. Moreover, the strong injection of means of payment during 1994 meant that the availability of cash did not constitute a major restriction on price hikes; the increase in real wages also stimulated consumption. In addition, in the light of the change of government, the private s ector appears to have made adjustments in anticipation of any institution of controls. (However, the new authorities retained regulated prices for only eight products.) The increases in jublic-service rates, especially in the second hall, which were designed to compensate for substan tial backlogs, also played a role.

Average real wages rose by slightly under 4%, as against 10% the year before, while minimum wages did not rise as much. While the new government had set itself the goal rf improving wages, it ran up against strong limitations owing to the massive fiscal deficit and higher inflation. In any case, the authorities decided to award persons earning the minimum wage an education grant equivalent to just under 2% of the wage. Moreover, in 1994, in contrast to the previous year, nominal wages in the public sector increased by a smaller percentage than in the private sector.

While GDP growth was slover than in previous years, the unemployment iate remained only slightly above 4%. In fact, there were signs of a labour shortage for some agricultural activities, such as the harvesting of sugar cane and coffee, which led to the employment of foreign workers.

c) **The external sector**

The current-account deficit remained high (US$ 515 million), although somewhat lower than in the previous year, as it dropped from 7% to 6% of GDP. Despite the improvement in the terms of trade (4%) and higher export volumes, the main contribution to the current-account imbalance stemmed once again from trade in goods, which posted a deficit of US$ 650 million. The surplus in real services increased slightly, mainly because of higher income from tourism. Net outlays for factor services remained at around US$ 200 million, a figure similar to that of the previous year. In 1994 there was a marked decline in capital inflows, which were under US$ 300 million; that amount represented only slightly more than half the average for the past five years. As a result, the current-account imbalance was covered largely through a drop in reserves, amounting to US$ 220 million.

The above-mentioned evolution in the capital account took place despite the fact that direct investment flows continued to increase (reaching US$ 300 million, equivalent to nearly 60% of the current-account deficit). The chief upset in financial movements took place in government operations, which posted a net deficit of US$ 250 million, as compared with an income of US$ 75 million the year before. This was partly due to the fact that in 1993 the public sector had incurred short-term debt in order to increase reserves, a debt which it had to repay in 1994. Despite the huge payments made by the Government, nearly US$ 90 million worth of arrears were accumulated on debts to the Paris Club.

Real exports of goods and services increased by 11% in 1994. Sales abroad of coffee and tourism services received a large boost, growing by 49% and 18%, respectively, and coming to represent 30% of the total. The value of coffee exports rose because of the steep international price increase, despite the withholding of 20% of the export supply, agreed on by the Association of Coffee Producing Countries, which was associated with a drop of i% in shipped volume. Meanwhile, banana exports increased by around 3%, despite the difficulties of gaining access to the European market. Total non-traditional exports increased by 10%, driven by higher sales of niscellaneous articles, which grew by 18% tc exceed US$ 1 billion; these offset the drops in the shrimp and fish and clothing categories In any case, non-traditional exports, which have expanded rapidly in recent years, laced greater competition from other countries in Central America and outside the subregion. Income from maquila exports remained practically unchanged from 1993; the investments mado in that activity reflected the impact of competition from economies with a cheaper laboi r force, as well as uncertainty over the efftcts of NAFTA. However, NAFTA'S implicit eroding of the preferences which Central American products had enjoyed in the United States market does not appear to have affected Costa Rican exports greatly in practice, except in the case of specific products, such as melons. During 1994 Costa Rica engaged in various trad; negotiations, including talks on the signing of a free trade agreement with Mexico.

Imports of goods continued to grow, although less rapidly than in the prev ous biennium. Purchases in other countries slackened, in an environment of reduced increases in domestic spending and less fluid financing, notwithstanding the lowering of : mport tariffs on intermediate and capital gooes, which were brought into line with the Central American common external tariff.

CUBA

1. General trends

After experiencing a deep slump in production in the years since 1990, the Cuban economy managed to halt its slide in 1994, growing by a modest 0.7%. However, per capita GDP remained close to the lowest levels to have been recorded during the past 20 years.

The improved economic performance seen in 1994 was related to Cuba's increasing foreign investment inflows, which boosted activities such as tourism, mining and some manufacturing industries. Economic reforms also had an impact, as they provided new opportunities for the operation of market mechanisms and led to the decentralization of business management. This prompted both the Government and agents of production to seek out new modes of economic behaviour. Furthermore, there was an improvement in the terms of trade thanks, in particular, to the rise in international prices for traditional export products, such as sugar and nickel, and a drop in petroleum prices.

After having risen to 34% of GDP in 1993, the fiscal deficit shrank by more than 70% in nominal terms to 7.4% of GDP. This made it possible to adjust monetary policy, which in turn helped to restrain inflationary pressures and to spark an appreciation of the local currency in the informal foreign exchange market.

Although the deficit on the current account of the balance of payments narrowed, it could not be financed entirely out of the capital account surplus, and the country therefore had to draw upon its international reserves lo cover the shortfall. In one noteworthy dsvelopment, tourism receipts amounted to more i han US$ 800 million in 1994; this meant that the tourism sector edged out sugar as the leading source of hard currency, since earnings from sugar îxports came to just US$ 700 million. This trend was the result not only of a considerable expansion of tourism services, but also of the country's smaller 1993-1994 sugar-cane harvest, whi:h was down to 4 million tons. This contraction hurt Cuba's chances of obtaining fresh external :redits, since the country's sugar output has tradi ionally been put up as a guarantee for such loan:,

2. Economic policy

The reforms initiated several years earlier continued apace in 1994. These measures have sought to diversify the country's forms of ownership and management and to give the market a greater role in the allocation of resources in an effort to make the economy function in a more viable manner within the overall framework of the existing model, which stresses distributive considerations. In 1994 measures were adopted to encourage foreign investment and tourism; in addition, markets for the sale of agricultural products were set up and steps were taken to downsize the State.

In the light of these developments, the accord reached by the National People's Assembly on 2 May 1994 was of particular significance; this agreement laid the formal groundwork for a new line of economic policy that would place emphasis on efficiency and on a strict control of national budget performance at all levels. Specifically, the Assembly en rusted the Government with the tasks of: i) reducing subsidies for corporate losses (as veil as other budgeted expenses) while at the same time increasing revenue with a view to significantly cutting the deficit; ii) ensuring the stability of funds deposited in the People's Savings Bank; iii) assessing increases in the prices and rates charged for selected products and services; and iv) phasing in a new, comprehensive tax system which would take considerations of equity into account while also helping to put Cuba back on a sound financial footing.

These economic liberalization initiatives made it permissible to conduct types of commercial transactions which had previously been considered illegal. This was an especially significant development in the case of foodstuffs, inasmuch as the greater mobility of output helped to alleviate supply problems towards the end of the year. Since 1993, the equivalent of 2.6 million hectares (most of the land held by the State) has been transferred to basic cooperative production units (UBPCs) for development. In October 1994, the transportation and sale of agricultural goods were deregulated. In addition, the involvement of private intermediaries in financial and commercial transactions was legally recognized. In a similar vein, special incentives, involving payments in kind and in hard currency, were offered to some 115,000 workers in high-priority sectors such as ports, fisheries, electric power generation, nickel production and the engineering, food, building materials and tobacco industries. In addition, the legal right to work on one's own account was extended to include 135 activities (mainly personal services) employing some 170,000 people, or about 5% of the economically active population. Nevertheless, these new economic units were not authorized to hire salaried employees, nor were they allowed to operate in the health or education sectors, with the free delivery of these services remaining an exclusive responsibility of the State.

The steps taken to downsize the State included streamlining the central government's structure and conferring greater operational autonomy upon public-sector enterprises and local authorities. Meanwhile, fiscal policy focused on reducing the deficit in public finances. Specifically, a system of taxation (which had, for all intents and purposes, ceased to function in 1967) was re-instituted in 1994; however, owing to the population's lack of experience with paying taxes, a transitional period of two years was envisaged before the system would become fully operational. June saw tie adoption of Decree-Law No. 150, which introduced tax evasion as a new offense in ttie Penal Code. During 1994, the Government also raised the prices and rates charged for a variety of goods and services in order to bodst government revenues, as well as implementing various cost-cutting measures.

The operational crisis besetting the economy and the reforms that were implemented had a number of social repercussions. One of those consequences was sharper income differentials (which were heightened by inflationary pressures); another was that lhe traditionally ample supply of services in such areas as education, health, sports and culture was constricted by greater funding sonstraints. The tension arising out of the conflict between social objectives and the difficult search for ways to boost production and strike a macroeconomic balance once again attested to tte seriousness of Cuba's economic problems, whose causes were to be found in both internal and external factors. Among the latter, the embargo imposed by the United States continued to weigh very heavily upon the country.

Efforts to improve relations between Cuba and the United States made seme headway in 1994 thanks to the agreenents reached concerning migration and th<; United States Government's authorization fori he restoration of telephone links between the two countries. In addition, talks were held between Cuban authorities and United States fir lis which would be interested in investing in Cuba in the event that the ban on such operations were to be lifted. Normalization of relations with I he United States would also pave the way for Cuba to gain access to credit from multilateral lendiig agencies.

a) **Fiscal policy**

The aim of fiscal policy was to reduce the public sector's sizeable deficil, and the fiscal deficit did in fact drop considerably (to 7.4% of GDP), thanks to a 24% jump in i icome and a 9% decline in expenditure.

One notable development in connection with government revenues was the hcrease in direct taxes on the earnings of self-employed workers, farmhands and members of cooperatives; the wages of government employees continued to be tax exempt, although a proposal was put forward that would require all workers to pay social security contributions. Meanwhile, revenue from indirect taxes on goods and services rose by nearly 50%, largely as a result of increases in a number of prices and charges. In particular, price hikes on cigars, cigarettes and alcoholic beverages had a significant impact on government income. In contrast, the adjustments made in the prices of fuels, electricity, postal and telegraphic services, and workers' cafeterias had less of an effect. Regulations concerning taxes on overseas trade and non-tax levies had yet to be defined. Furthermore, the practice of subsidizing those products included in the family shopping basket was continued in view of the administrative difficulties entailed in the policy alternative, which would involve concentrating transfer payments in low-income sectors.

On the expenditure front, a decrease was seen in outlays on personnel, goods and services, and transfer payments to public-sector enterprises. This trend thus attested to the financial impact of the steps taken to streamline the structure of the central government and to decentralize business operations. The administrative reorganization begun in April ushered in changes in the existing institutional framework, which had been geared to the demands of integration with the former bloc of centrally-planned economies. As a result of this governmental overhaul, 15 ministries and other bodies were eliminated and the civil service was reshaped in line with the reforms that were being undertaken; specifically, the formulation of macroeconomic policy was entrusted to the Ministry of Economic Affairs and Planning and the Ministry of Finance and Pricing, while the Ministry of Foreign Investment and Economic Cooperation was created to handle issues related to inflows of external capital. The downsizing of the civil service translated into an 11,500-job reduction in the government payroll and a gradual reclassification of employees.

Public spending on health and education was cut back; specifically, this entailed the introduction of charges for a number of services -such as the meals served to students at elementary-level boarding schools, the teaching materials used in universities, anil supplies of a drug to combat the epidemic cf neuropathic diseases- which had previously seen provided free of charge. Similarly, it was decided that attendance at sporting and cultura I events would no longer be free. In addition, the subsidies provided to cover the losses ol' State-owned enterprises were reduced. The management of corporate finances was also nore strictly controlled, and a considerable reduction in the volume of business firms' accounts receivable was therefore seen during the year.

The social security system conlinued to place a heavy burden on government coffers. This system's deficit was a reflection cf the shortfall it was experiencing in the face of the large numbers of people -more than 10% of the population- who were drawing retirement benefits or pensions and the mounting level of wage-based subsidies being paid to workers hurt by adjustment measures.

b) **Monetary policy**

Any analysis of the monetary situation in the Cuban economy should take inte account the special features of its system of business transactions. A number of different markets coexist, and they differ from one an ather in terms of the methods by which buyers ard sellers gain market access, their degree of formality, their price determination modalities, and the means of payment employed. A variety of economic circuits can thus be said to exist, each with its own method of operation. As of lale 1994, three different currencies were in circulation: the Cuban peso, the dollar and a convei tibie peso (to which, in a number of cases, rationing instruments should be added). Cubí n pesos were used in the government-regulated, formal market. In recently-opened markets, in which prices were freely determined, trans ictions could be conducted in all three currencies. This was also the case in informal markets. In the State-run dollar stores, purchases could be made (at controlled prices) either in dollars or in convertible pesos. As a general rule, public-sector workers were paid in Cuban pesos, while workers in the tourism industry, foreign firms, or activities accorded a high priority received part of their pay in hard currency. Public-sector enterprises conducted transactions both in local and foreign currencies; the existence of two sets of accounts increased the complexity of management operations.

The convertible peso, whose dollar parity was fixed, was introduced for use in State-run shops in December 1994 (after several postponements occasioned by the country's low level of international reserves). The expectation was that it would continue to be lawful to hold dollars (it being estimated that one fourth of the population already had access to dollars, albeit in small amounts), but that their circulation would not be allowed; authorized stores would therefore deal solely in convertible pesos.

In any event, the monetary authorities sought to tighten the money supply in 1994. This led to an appreciation of the Cuban peso on the informal foreign-exchange market and to a slow-down in the inflation rate. The general public held a substantial portion of liquid assets in savings accounts in anticipation of a currency exchange, while interest rates on bank deposits did not fall into step with prevailing price trends.

c) **Foreign exchange and trade policies**

In view of the domestic economy's operational requirements and the country's changed international position, the official parity of the Cuban peso came under scrutiny in 1994. Nevertheless, no change was made in the exchange rate of one peso to the dollar, which had been in force for the past three decades. The price of the dollar on the informal market remained far higher than the official rate, but it did drop considerably (from 150 to 50 Cuban pesos) over the course of the year.

As part of the Government's policy of opening up the economy, foreign trade operations were decentralized, and a majority of them were therefore transferred to public-sector enterprises. At the same time, the practice of selling some of the stock h public-sector enterprises to foreign investors proceeded, with the idea being to step up this process and to extend it to include all production sectors.

As of late 1994,180 joint ventures involving external financial inputs totalling about US$ 1.5 billion had been set up with firms from 38 countries (primarily Spain, Canada, France, Italy and Mexico). These operations encompassed a total of 26 different activities, with a concentration in tourism and in hydrocarbons. Thus, a number of these ver tures were in operation in the tourism and hotel management industry, and agreements were concluded regarding the use of risk capital for the exploration of potential oil fields and mining deposits. Other such partnerships dealt with the production of textiles, leather goods, perfumes, toiletries, rum, fruit juices, beur and mineral water. The largest joint ventures entered into during the year were in telecommunications and in the mining of nickel. Another five were set up in the agricultural sector, particularly for citrus crops. In addition, the first such negotiations to be conducted in connection with the real estate industry were undertaken, and there was a possibility that these talks might be broadened to include other service activities. It was anticipated that foreign investment would play an increas ingly important role in the real estate sector in the areas of sales, rentals and time-share contracts. In the financial sector, five foreign banks were maintaining offices in Cuba.

The authorities announced that a new foreign investment law would be enacted which would seek to encourage the inflow of capital by offering investors guarantees h keeping with international practices. In a similar vein, agreements for the reciproca! protection of investments were signed with, the Governments of Italy, the United Kingdom, Spain, Canada, the Russian Federation and Colomb a, and headway was being made towards the conclusion of similar agreements with Germany and Switzerland. In another development in 1994, Cuba joined the Association of Caribbean States, thereby entering into its attendant commitments regarding ntraregional cooperation and trade.

3. Them n variables

a) Economic activity

Total supply rose slightly as a result of an upsurge in both output and imports. On the demand front, the resurgence in private consumption contrasted with declines in public consumption and fixed capital formation.

The slight increase in GDP was attributable to the expansion of manufacturing (8%), tourism (6%), electricity, gas and water services (4%) and mining (1%); in contrast, the sugar-cane harvest was down and agriculture as a whole turned in a poor performance.

The agricultural sector suffered a decline for the second consecutive year owing to a drop in farming activity (both in sugar cane and in other crops) even though livestock and poultry production both showed some signs of recovery. A shortage of inputs, adverse weather conditions and insufficient motivation on the part of the labour force all had a negative effect in terms of the tasks of cropland preparation, planting, cultivation and harvesting. The incentives created by the deregulation of the agricultural sector did not begin to make their effects felt until late in the year.

Activity in the sugar-cane industry continued to follow the downward trend of the early 1990s: output amounted to some 4 million tons, which was about half of what it had been five years earlier. Meanwhile, the difficulties facing other agricultural activities served to aggravate existing food shortages up until the final months of the year. In particular, tuber and vegetable production declined for the second year running, although rice and maize output increased. The tobacco and citrus-fruit harvests were larger, thanks to the foreign-currency self-financing arrangements that were in place. New systems for prefinancing the country's sugar output were also introduced in 1994. These mechanisms (which did not entail any privatization commitments) provided for the purchase of fertilizers, herbicides, spare parts and other inputs which were then paid for out of the earnings, from the harvest. The authorities were projecting a harvest of more than 5 million tons of raw sugar for the 1995/1996 crop year. The introduction of new mechanisms to boost worker productivity was being planned, as was the use of ioreign capital to expand the sugar industry's refiling capacity.

In contrast, livestock production rebounded, thanks to an expansion of the cattli; herd -which grew to 4.6 million head- and an in< Teased output of milk, eggs, poultry and pork.

The divestiture of most State-owned land through the creation of basic cooperative production units (UBPCS), which had begun in 1993, was completed in 1994. This, by the end of the year, only 25% of the arable area in Cuba remained in government hands. In October, agricultural produce markets entered into operation (in each of the country's nunicipalities and in 29 locations in Havana) in which prices were freely determined by supply and demand. Farmers in the private sector were luthorized to sell their produce in these markets; the produce from State-owned productior units and cooperatives could also be sold in these markets, once their obligations in respect OK sales to the Government had been fulfilled. It was decided that farmers could either sell their produce directly in these markets or through ¡ i commercial agent -an arrangement that implied i recognition of the role of market intermediaries. Mounting volumes of an entire range of farm p roducts were being sold on these markets, but the sale of potatoes and of cattle products (such as meat, milk and cheese) was still not permi ted. Sales of these items were taxed at a rate \rtiich varied according to the locality concerned.

The trends observed during the closing months of 1994 indicated that the private sector accounted for around 75% of these sales, in spite of the fact that it held just a fraction jf the arable land. State production surpluses accounted for another 15% of these sales, with the cooperative sector providing the remaining 109 *o* (4% from the UBPCS and 6% from the Agricultural Production Cooperatives). The abovî breakdown of the flow of products being channeled to these new markets was a reflection of the Government's firm commitment to providing a subsidized supply of such itens for the State-controlled sector, as well as tf the effort being made to promote a variety ol exportable crops (e.g., citrus fruits) to which a considerable percentage of the country's arable land has been devoted.

Bringing about a recovery in agricultural production, including that of State-owned farms and cooperatives, was one of the country's political priorities. In the past, the agricultural sector had based its operations on input-intensive techniques involving the use of fertilizers and the mechanization and electrification of production processes. In recent years, however, the sector had been suffering from an acute shortage of fuels, fertilizers, herbicides, spare parts and other inputs which severely hampered production. These and other problems resulted in a situation in which, as one example, most of the more than 1,500 UBPCS devoted to sugar-cane production proved to be unprofitable in 1994.

As a result of the slump in agricultural production, food imports amounted to approximately 20% of the total. The high level of rice imports -a staple in the population's diet- was particularly noteworthy. In spite of the fact that Cuba has suitable land and infrastructure for rice production, the 1994 harvest was only half the size that it had been five years earlier. An increase in the country's production of vegetable fats -which were also being imported owing to an insufficient local supply- was also believed to be feasible.

The mining sector expanded for the third year in a row, boosted by larger foreign investment flows; oil production showed growth (up 18%, to 1.3 million tons), as did the output of natural gas, copper and zeolite. By the end of 1994, risk contracts had been signed with overseas companies for the exploration, drilling and extraction of oil in 19 tracts representing more than half of the country's potentially productive areas; hydrocarbon output for 1995 was projected at 1.5 million tons, or three times as much as in the late 1980s. Despite the potential for nickel and cobalt ore production, output declined yet again, on this occasion by 10%. Contracts were signed with two companies, one Canadian and one Australian, in 1994 with a view to regaining former production levels of this ore.

There was an upturn in manufacturing, although the sector continued to be hampered by shortages of fuel, raw materials, spare parts and other imported inputs. Nevertheless, with no more than a few exceptions, output did increase in the various branches of industry, and especially in fuel, non-electrical machinery, construction materials, textiles, beverages and tobacco. In contrast, there was a drop in sugar production.

Construction witnessed a slight downturn, despite building activity in the tourism, agricultural and other foreign investment-related industries. Residential building rose by 13%; a particularly sharp increase in the construction of homes for agricultural and sugar-industry workers reflected the effort being made to maintain the labour supply in th< se two sectors.

Following the steep downhll slide of the energy sector seen during he preceding four-year period, in 1994 the sector experienced an upturn thanks to a greater supply of hydrocarbons, which made it possible to increase its generation of electricity. ! however, as a consequence of the deterioration of the country's thermal power plants due 1o insufficient maintenance and repairs, power failures continued to occur, although they lasted for shorter periods than they had until recently. In 1994 new types of incentives were also introduced for workers in the electricity sector, and this contributed to an impiovement in the operation of generating plants and of transmission and distribution networks.

The growth of the tourism sector was a key feature of the Cuban economy in 1994. The main tourist centres are the city of Havana and the beach resort of Varadero, but investments were also channelled into developing Í acuities in other areas, especially the islets along the northern coast. There were also plans to promote eco-tourism and water sports, but constraints associated with the economic embargo halted the development of cruise ship activities. None the less, with the help of foreijm capital, the construction of the first docking facilities for cruise ships in the port of Havan; t did make some headway. Tourism was estimated to be the direct source of some 50,000 jobs and, indirectly, of another 200,000. Hotel capacity reached 24,000 rooms, with a further 27,000 rooms being slated for construction by the end of th<; 1990s, with the assistance of foreign investment. Tourism was instrumental in generating demand for a range of locally-produced products, although a considerable portion of the necessary inputs were purchased abroad.

b) **Prices, wages and employment**

Any analysis of price levels and movements is complicated by the existence of segmented markets and by Cuba's use of different units of accounts and means of payment. The country's market segmentation was associated with wide price spreads for identical products. For example, the price (in dollars) of petrol in the informal market was almost 45% below the price charged (in the same currency) by State-owned petrol stations, which in turn were selling rationed fuel at a significantly lower price (expressed in Cuban pesos). Other notable examples were rice and beans, which fetched much higher prices (around 30 times as much) in the free market than in the regulated market, where they were sold at subsidized price levels.

In 1994, a considerable increase in consumer prices was recorded in the formal sector, which primarily deals in the local currency. Thus, the consumer price index registered a 28% increase for merchandise and a 50% jump in public food prices. Particularly steep increases were seen in such products as cigarettes, twists of tobacco, beer, rum, aguardiente and fuel for private motor vehicles. In September, residential electricity rates were increased for monthly consumption levels over 100 kilowatts (this was estimated to apply to around one half of all households). Price hikes were also instituted for transport by rail, air and sea, as well as for long-distance bus trips. The charges for water and sewerage services rose, as did both domestic and international telegraphic and postal rates. Retail prices for workers' cafeterias also climbed. However, a reform of the retail price system, which would have entailed reductions in the subsidies for products included in the population's basic shopping basket, was postponed.

In the informal sector, which accounted for a significant portion of retail trade, prices fell due to the lower level of liquidity and the deregulation of agricultural markets. In dollar stores, prices dropped slightly after having risen sharply in 1993. Sales by these stores may well decline if restrictions imposed by the United States Government on transfer payments by that country's residents to Cuba prove to be effective.

Despite the increase in the cost of living caused by newly-implemented fiscal measures, the increase in official prices and the elimination of many free services, public-sector wage rates were not raised. In activities class fied as being of a high priority, incentives involving payments in kind and in United States dollars were introduced in an effort to raise the productivity of labour. On the government wige scale, the average wage (excluding these incentives) was about 190 pesos, while the minimum and maximum wage rates were 100 aid 450 pesos, respectively.

Staff strength in semi-publk enterprises remained unaltered owing to a concern about employment levels, despite an aw£reness of the fact that these firms' manning tables exceeded their technical requirements. A benefits scheme for unemployed workers was in effect under which they were guaranteed a payment equivalent to 100% of their wage for the first month and subsequent payments equivalent to 60% of their regular wage for a period whose duration depended on the numbei of years of service. (For example, a worker wilh 20 or more years of service to his or her credit v 'ould receive payments for a period of 18 montlis.) Workers would, however, lose their entitlenents if they rejected a specified number of suitable job offers.

The increase in opportunities for private enterprise created new jobs (which in some cases afforded higher pay levels than ihose of the public sector), but not enough to provide work for the entire labour force, especially the young working-age population. In orcer to avert transportation problems, retraining programmes have been implemented which make it possible for people to obtain employment in establishments close to their homes,

c) **The external sector**

The balance-of-payments current account deficit narrowed in 1994 as a result (if a decrease in the merchandise trade deficit and a surplus on the balance of real services; in contrast, unrequited private transfer payments were thought to have stagnated while, in spite of tax incentives for reinvestment, the repatriation of profits by foreign firms increased. For its part, the capital account posted a surplus thanks to the level of direct investments and unrequited official transfer payments. However, given the shortage of external loans, capital inflows were not large enough to cover the whole of the current account deficit, and the country therefore had to draw down its international reserves still further.

The shortage of foreign exchange meant that the external debt could not be fully serviced; consequently, the level of debt, measured as a percentage of exports of goods and services, remained high. However, by making use of debt swaps, Cuba was able to make some headway in amortizing the nearly US$ 350 million of debt it owed to Mexico. Through such swaps, Mexico invested in the Cuban telecommunications firm and expanded its investments in tourism and in cement production activities. In another development, the Canadian Government resumed its flow of assistance to Cuba.

Exports of goods rose by almost 16%. Sugar accounted for approximately 70% of all external sales in the first nine months of 1994, with minerals being the source of a little over 10% and fishery products, medicines and medical equipment, and tobacco and related products each making up about 5% of the total. The value of sugar exports rose owing to the increase in international prices, which mon than offset the drop in sales volume. Nickel also fetched higher prices, and its export volumes climbed as well. Exports of pharmaceuticals and biotechnology products continued to expand, reaching over US$ 100 million. Some of the riajor categories of merchandise imports, which declined by 4%, were fuel (40% of the total value of imports in the first nine months of the year; and food (20% of the total during the same period).

In the country's services trade, the chief highlight was the increase in the number of tourists visiting the island. Tourist arrivals totalled approximately 620,000, jp 13% over the year before. This reflected the expansion of hotel facilities and service infrastructure and an improved international publicity campaign, in all of which external capital was heavily involved. In August, however, the flow of visitors began to taper off, and the Government's 1 JS$ 900 million target for gross tourism receipts could therefore not be achieved; instead, receipts amounted to just US$ 800 million, with n< t profits being estimated at 30% of that figure. Tourist arrivals' main countries of origin in 1994 vere as follows: Canada (17%), Italy (10%), Spain (10%), Argentina (8%), Mexico (8%), France (5%) and Great Britain (4%).

CHILE

1. General features of recent trends

The adjustment programme that had been implemented by the Chilean authorities since the previous year realized its chief objective during 1994: to cut inflation while maintaining growth. The inflation rate fell below 9%, its lowest level in the past 30 years, and the gross domestic product (GDP) rose 4%, which brought the average annual growth rate for the past 11 years to around 6.5%.

The attainment of the growth and inflation targets outlined at the start of 1994 was made easier by an unexpected improvement in external conditions, so that the balance of transactions on both the current account and the capital account was substantially strengthened. This situation was reflected in a moderate but persistent appreciation of the peso, which, in November, led to a 10% drop in the central value of the exchange rate band.

With the favourable trend in the terms of trade, national income went up by 6.5%, which enabled the adjustment programme to reduce the current-account deficit from the preceding year's level of around 5% of GDP to 2.2%. The merchandise trade balance showec a surplus of US$ 660 million.

While consumption posted somewhat lower growth than output, domestic saving (in 1980 dollars) accounted for one fifth of GDP, the highest ratio in the country's history. Meanwhile fixed-capital investment remained at the high 1993 level of 22% of GDP. Despite tt\e slowdown in income, which is characteristic of an adjustment programme, the public sector again helped to generate savings, this time contributing an amount nearly equal to 5 percentage points of GDP (in current values).

The sharp decline in domestic demand eroded the pace of job creation and raised the unemployment rate from 4.7% to 6%, which, nevertheless, was one of the lovest average annual rates in the past two decades. The increase in real wages (4.5%) was greater than that of average productivity (3.5%-4%).

2. Economic policy

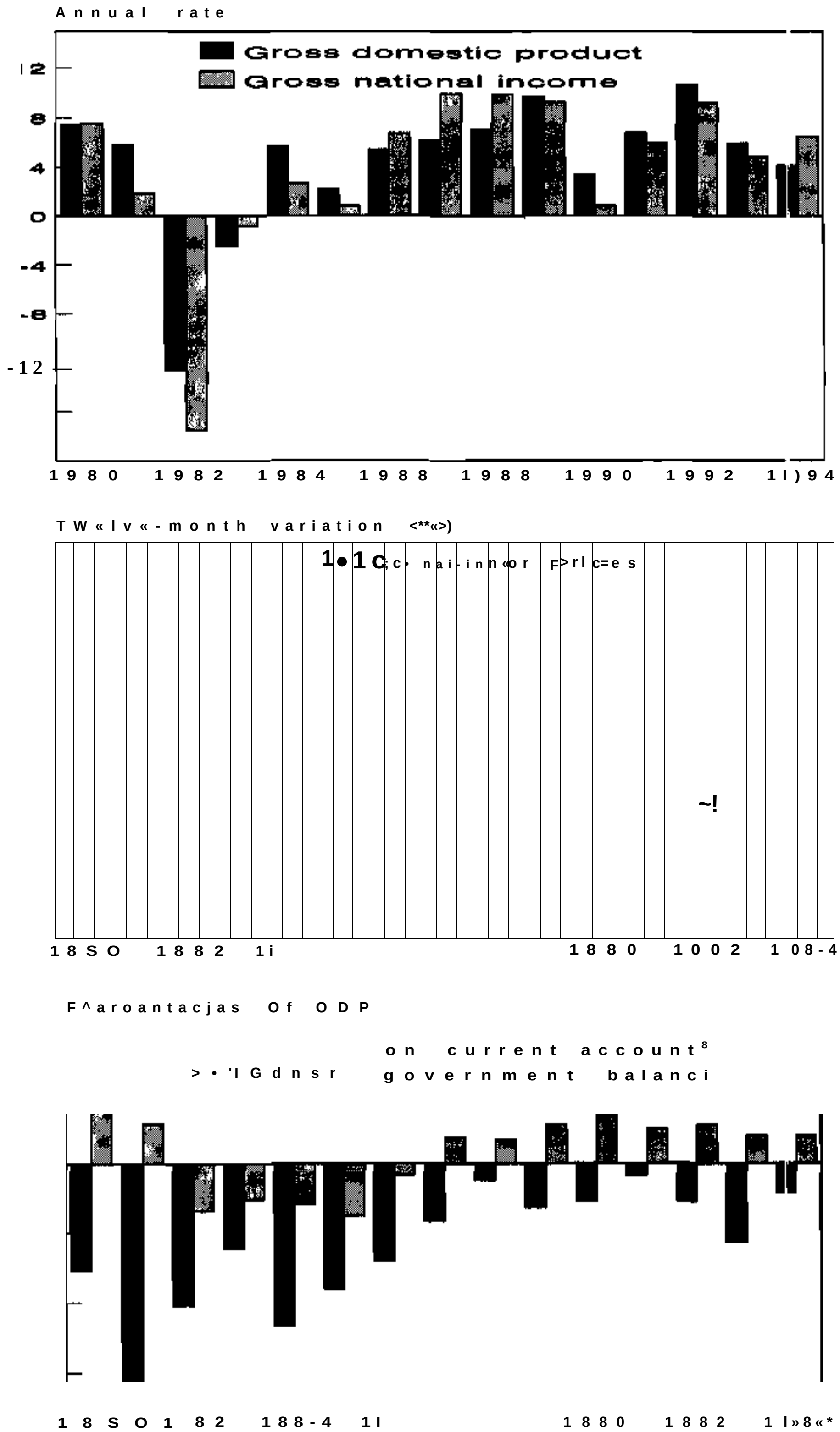
The main feature of 1994 was the deepening of the adjustment effort, whose aims were to reinvigorate the battle against inflation and to curb the growth of spending, thereby bringing it in line with the development of productive capacity, as well as the initial forecasts of adverse trade balances.

In the previous two years, pent-up demand had exerted pressure on the prices of non-tradable goods and on the current-account balance. It seemed essential to continue to reduce expenditure, in view of the single-digit inflation target and external climate which, at the beginning of the year, was less than auspicious.

The estimates made for 1994 at t le end of the previous year had indicated a further drop in the price of copper (still the country's main export product), a trade deficit of nearly US$ 1 billion and a current-account deficit of aro and US$ 2.4 billion, or 5% of GDP. Moreover, successive rises in United States interest rates made it necessary to adjust to a smaller flow of extern il resources.

The authorities therefore pressed on with a policy aimed at curbing the growth c f output and expenditure, which in 1993 had gone up by 6% and 8%, respectively. Under this policy, adjustment was to be accompanied b y financing, which meant accepting a current-account deficit

Figure 1
CHILE: MAIN ECONOMIC INDICATORS



Source: ECLAC, on ... official figures.

somewhat higher than the trend level (3%-4% of GDP).

However, because of the improvement in the terms of trade and continuing high domestic interest rates, the current-account deficit did not, in practice, amount to even half the trend value.

In a more favourable external climate than had been anticipated, the control of expenditure was reflected in a moderate downturn in domestic activity, whose impact on unemployment was greater than had been expected. The spending curb combined with a downward trend in the exchange rate to make it easier to attain the inflation target.

The adjustment process, undertaken at a time of uncertainty in the international markets, strengthened the credibility of the economic authorities. Its effects were seen mainly in consumption. Long-term interest rates had, in fact, been lowered at the beginning of the year, strengthening the assumption that the adjustment period would be short.

The unexpected boost from the international recovery increased export prices and volumes, prompting an upward revision of the growth forecasts and a downward revision of the trade and current-account deficit projections. The trends in the terms of trade and the volume of exports, which had helped to slow expenditure and output during the second half of 1993, began to act as a stimulus in the second quarter of 1994. Added to the improvement in the trade balance was the expansion of foreign investment, which, after accounting for 6% of GDP in the previous year, soared by over 70%. The abundance of foreign exchange led at the end of November to an adjustment in the foreign exchange policy, whereby the reference dollar was brought into line with the market value of the dollar through a drop of nearly 10% in the value of the *"dólar acuerdo"*.

At the end of 1994, in the light of the downward trend in inflation and the positive developments in both total expenditure and the external accounts, the authorities revised their growth forecasts upward for the following year. This outlook was maintained during the first half of 1995, notwithstanding the crisis which shook Mexico and affected the region's countries to varying degrees.

In Chile's case, the Mexican crisis had a direct, if temporary, impact on th; interest rate, the exchange rate and stock prices. If 20 December 1994 is used as a yardstick, the stock market index, expressed in dollars, had accumulated a loss of 15% by mid-March, but by the end of May it was already 20% above the reference level. The interest rate on long-term Central Bank debt rose slightly, bit by mid-year it was clear that this rate's level md trajectory were due primarily to domestic factors resulting from the rapid growth of domei tic spending. Meanwhile, although the exchange rate climbed during the first two months of 19! >5, it tumbled over the following months, owing to the abundant supply of foreign exchar ge.

In short, the impact of the Mexican crisis on the Chilean economy was of limite* I duration and scope, being confined to the first quarter of 1995 and to fluctuations in financial variables, without affecting real variables. During this period, economic activity expanded bj nearly 7%, expenditure by 10% and fixed capital formation by over 5%. Unemployment lias dropped gradually from a peak of 6.7% in Ssptember and October 1994 to 5.3% in the quaiter ending in April. In May, the 12-month inflation rate reached 7.4%, which was in line with the 8% annual target.

Owing to the surge in exports, the trade balance posted a surplus of US$ 1.45 billion in mid-May 1995, more than quadruple the figure of one year earlier, notwithstanding a rise in imports of around 30%. Meanwhile, the balance of payments showed a cumulative surplus of US$ 490 million.

a) **Fiscal policy**

Public-sector fiscal management generated considerable savings during 1994 vhich made it possible to reduce both foreign and (lomestic debt and to finance a further increase in investment.

General-government saving was around 5% of GDP, with the cumulative resources of the Copper Stabilization Fund accounting for an additional two percentage points. The overall surplus (2% of GDP) was somewhat smaller than in 1993, owing to the sharp increase (11%) in public investment, mainly in infrastructure.

Table 1

CHILE: MAIN ECONOMIC INDICATORS

	987	1988	1989	1990	1991	1992	1993	1994'
	Growth rates							
Growth and investment								
Gross domestic product	6.1	7.0	9.7	3.3	6.8	10.6	5.9	4.1
Per capita gross domestic product	4.4	5.2	7.8	1.6	5.0	8.8	4.2	2.4
Gross national income	9.9	9.9	9.3	0.8	6.0	9.2	4.8	6.5
Gross domestic product by sector								
Goods	5.3	9.2	10.2	3.5	5.0	8.6	4.7	3.7
Basic services	8.2	7.7	7.6	3.4	14.8	15.9	6.7	7.4
Other services	5.3	4.6	7.3	3.2	6.8	9.7	6.0	3.6
	Percentages							
Contribution to growth of GDP [c]								
Consumption	3.1	4.7	6.3	-0.4	3.7	5.2	4.4	2.4
Government	•0.3	0.4	0.4	0.1	0.4	0.5	0.3	0.2
Private	3.4	4.4	5.9	-0.5	3.3	4.7	4.1	2.2
Gross domestic investment	3.8	2.0	3.9	0.8	0.3	4.9	2.7	0.2
Exports	1.9	3.2	4.3	3.4	3.8	5.4	1.6	2.3
Imports	•2.7	-2.8	-4.8	-0.4	•1.1	-4.8	-2.8	-0.9
	Percentages of GDP							
Gross domestic investment	16.9	17.6	19.7	19.8	18.8	21.4	22.8	22.1
National saving	13.8	16.7	17.3	17.8	18.1	19.1	17.8	20.1
External saving	3.1	0.9	2.4	2.0	0.7	2.4	5.0	2.0
	Percentages							
Employment and wages								
Activity rate	50.9	52.0	52.6	52.5	52.3	52.8	54.5	54.7
Open unemployment rate [e]	9.4	8.1	6.2	6.0	6.5	4.9	4.7	6.0
Real minimum wage (Index: 1990=100)	79.0	84.5	91.3	100.0	109.3	114.3	120.0	124.4
	Growth rates							
Prices (December to December)								
Consumer prices	21.5	12.7	21.4	27.3	18.7	12.7	12.2	8.9
Wholesale prices	17.1	3.3	22.8	25.7	16.5	8.9	6.7	7.8
External sector								
Terms-of-trade effect (Index 1990=100)	103.2	114.8	110.7	100.0	97.8	93.5	86.7	95.6
Nominal exchange rate (pesos per dollar)	220	245	267	305	349	363	404	420
Real effective exchange rate (Index: 1990=100)	96.3	102.0	96.4	100.0	98.9	95.3	96.6	95.5
	Millions of dollars							
Balance of payments								
Current account	-869	-281	-861	-794	-287	-1 100	-2 418	-1039
Balance of trade in goods and services	809	1625	1063	1007	1 514	726	-935	719
Exports	6 309	8 266	9 575	10 214	11047	12 418	11834	14 389
Imports	5 500	6 641	8 512	9 207	9 533	11692	12 769	13 670
Capital account	1004	1 108	1430	3 125	1 536	3 646	2 838	4 233
International reserves (variation)	79	867	581	2 324	1341	2 443	558	3 708
	Percentages							
External debt								
Gross debt (as percentage of GDP)	99.1	79.3	64.0	62.4	52.3	47.1	46.2	47.2
Net interest (on exports)	23.6	19.5	16.1	14.5	10.6	7.8	6.0	4.8

Table 1 (conclusion)

	1987	1988	1989	1990	1991	1992	1993	1994[a]
	Percentages of GDP							
General government								
Current income	29.3	27.7	26.0	26.6	26.9	27.5	27.4	27.5
Current expenditure	25.5	22.8	21.4	21.0	21.8	21.9	22.4	22.1
Saving	3.8	4.9	4.7	5.6	5.1	5.6	5.0	5.3
Capital expenditure (net)	2.0	3.2	1.9	2.2	2.7	2.8	3.0	3.3
Financial balance	1.9	1.7	2.8	3.5	2.4	2.8	2.0	2.0
	Growth rates							
Money and credit								
Banking system monetary balance								
Net international reserves	140.2	-26.0	25.2	124.6	34.8	62.8	17.8	
Net domestic credit	-10.3	108.8	27.2	-10.8	36.2	-19.4	39.7	
To the public sector	17.3	3.5	-8.3	18.6	14.3	-2.9	11.8	
To the private sector	-7.0	24.9	37.3	16.1	22.4	37.0	30.2	
Money (Ml)	5.5	53.5	5.5	27.0	39.7	21.2	29.2	22.5[11]
Savings and time deposits in local currency	53.8	24.5	30.8	32	36.9	32.4	22.5	17.4¡"
M2	38.5	31.5	23.7	30.8	37.6	39.7	24.0	18.8[11]
Dollar deposits	33.8	50.2	46.8	28.7	23.2	-17.2	31.3	
	Annual rates							
Real interest rates (annualized)								
On deposits		2.1	7.6	10.4	3.1	5.0	5.3	5.7
On loans		5.1	11.9	17.1	8.4	10.0	10.8	10.4
Equivalent interest rate in foreign currency [8]		11.1	16.9	24.0	10.2	16.5	5.9	22.2

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. Based on 1980 dollars at constant prices. [c] Measures the impact of the variation o f each aggregate on the growth of GDP. Derived by multiplying the annual rate of variation of an aggregate by the ratio of that aj ;gregate to GDP. Percentages of the working-age population. [e] Percentages of the economically active population. Refers to net balance-of-payments interest on exports of goods and services. [8] Interest rate on deposits deflated by the variation in the exchange rate. Private sector.

Table 2

CHILE: MAIN QUARTERLY INDICATORS

	1992				1993				19)4[a]			
	I	II	III	IV	I	II	III	IV	I	II	III	IV
Gross domestic product (Index: 1990=100)	115.2	116.5	121.4	123.5	124.3	125.9	128.2	128.0	129.3	131.8	.33.0	133.9
Consumer prices (12-month variation, %)	18.0	14.5	15.1	12.7	12.7	13.0	12.3	12.2	13.7	12.7	10.5	8.9
Real exchange rate (Index: 1990=100)	95.1	93.1	99.3	93.7	95.1	98.9	96.4	95.9	95.6	94.8	96.7	94.7
Real interest rate (Annualized, %)												
On deposits	6.4	3.5	-0.8	10.8	4.0	5.7	3.2	8.4	3.1	7.6	5.9	6.0
On loans	12.9	7.8	3.1	16.4	9.5	10.2	8.6	14.7	8.1	12.2	10.7	10.8
Money supply (MlA)[b] (12-month variation, %)	56.9	46.0	35.4	29.9	6.9	17.2	14.7	22.2	13.9	15.7	19.9	22.5

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. Private-sector money.

Thus, the authorities played a counter-cyclical role, given that the adjustment process had resulted in a weakening of private investment. The overall surplus was used to amortize around US$ 610 million in both foreign and domestic debt.

Real tax receipts, excluding copper revenues, grew somewhat less than output (3%). This was due to the entry into force of cuts in personal income taxes and to the slower growth of domestic demand and imports. The fact that imports began to recover only in the second half of the year, combined with a falling dollar, led to a drop of nearly 7% in the yield from foreign trade levies.

In accordance with the policy implemented in recent years, current expenditure grew less than output, and the total expenditure increase was not greater than the rise in potential income. Thus, current spending grew by slightly more than 3% in real terms and total spending by less than 5%. Wage trends were similar in the public and private sectors, with public-sector wages increasing by over 5%.

Public enterprise subsidiaries of the State-owned Production Development Corporation -13 health care companies, 3 electricity companies, 5 transport firms and 3 coal companies- generated net earnings worth more than US$ 100 million, which was double the previous year's figure.

b) **Monetary and exchange rate policies**

On the basis of the downward trend in inflation, the slowdown in expenditure and the favourable outlook for the external sector, the authorities declared in mid-November that the adjustment process was complete. They then proceeded to lower the short-term interest rate on Central Bank readjustable paper to 6.1%, after reducing it to 6.25% in mid-October, thereby ending a 22-month cycle during which the rate had remained unchanged at 6.5%. Furthermore, the limits and rules applied to the activities of institutional investors, private pension funds, life insurance and general insurance companies and foreign mutual funds were broadened and relaxed.

The lowering of long-term interest rates at the beginning of 1994 helped to ensure that the adjustment programme did not affect the high investment ratio. The reduction in short-term domestic rates and the increase in foreign rates had narrowed the arbitrage margin, while at the same time, a 30% reserve requirement on short-term external loans had been maintained. By the end of the year, the margin for interest rate arbitrage had all but disappeared, in contrast to the situation with regard to exchange rates, as the expectations of an appreciating exchange rate increased.

At the beginning of February 1994 the Central Bank suspended bidding on 4-ycar readjustable instruments, which resulted it a widespread lowering of interest rates on longer-term notes. After that date, the Bank stuck to 90-day and 8-, 10-, 12-, 14- and 20-year instruments.

In mid-April the Central Bank adopted a set of measures to ensure further liberalization of the foreign-exchange market and other measures intended to do the same for the capital account. The first group raised the percentage of export revenues exempt from the obligation to sell foreign exchange on the formal nr arket from 10% to 15%; extended the time-limi for such sales from 150 to 180 days; and incrensed the amount exempted from US$ 5 million to US$ 10 million. These measures were intended to facilitate cash management for exporters by ensuring greater sales flexibility and greater avails bility of foreign exchange.

The measures to liberalize the capital account consisted of lifting some of ¡he restrictions applied to companies issuing American Depository Receipts (ADRS) and public offering bonds abroad and raising the upper limit on the foreign investments of private pension funds from 3% to 4% of their total resources.

The continuing nominal appreciation of the peso dominated the monetary and foreign-exchange situation during 1994. *¡ SX* the beginning of the second half of the year, money creation through foreign-exchange opérations began to expand rapidly, exceeding thi; inflation and growth estimates. The annualize! growth rate of private money, which had been around 14% in May, rose to 21% in October. This was due not only to the drop in the estimated cost of holding money, in view of the lower inflationary expectations, but also, and especially, to the foreign-exchange operations which the authorities were forced to carry out in order to maintain the flotation band.

Between January and October 1994 the value of the dollar dropped 4%. During November, it remained on the floor of the band, a sign that the market was pushing for harder revaluation, on the basis of the strong showing by the trade balance and the capital account, which had generated a steady increase in the Central Bank's international reserves. Because of its massive purchases of dollars, the Bank had sustained copious losses, for, while the subsequent increase in its reserves had generated profits, it had also forced the Bank to carry out much more costly open-market operations in order to cushion the monetary impact.

The gap between the market value of the dollar (the average bank value) and the *"dólar acuerdo"* had gradually increased from the 6% registered in 1993. The nominal value fell from 430 pesos in January to 411 pesos at the end of November, while the value of the *"dólar acuerdo"* reached 462 pesos. By the end of November, the gap had grown to 10%, fuelling expectations of an appreciating exchange rate and sales of dollars to the Central Bank. Since the resulting monetary impact began to undermine the feasibility of the 1995 inflation target, the Bank modified its exchange rate policy at the end of November, lowering the flotation band by 10% and changing its internal structure.

From then on, the Central Bank established a new reference value for its basket of currencies, around which it allows fluctuation! of up to 10% on either side of the flotation bard. While this reference value came to rest on the floor of the previous band, that in itself did net constitute a revaluation, since it remained subject to market reaction. Strictly speaking, the value of the dollar could have dropped 10%, as the flo jr of the band had fallen by that amount, but the in itial drop was only 4%.

In addition, the Central Bank reduced the relative weight of the dollar with in the basket of currencies from 50% to 45%, raised the yen's share from 20% to 25% and kept that of the deutsche mark at 30%. It also took steps to increase the net demand for foreign exchange, eventually requiring dollar-only cash reserves on foreign loans, a measure aime d at curbing speculative capital flows; abolished the upper limit on the bank's foreign exchange position, in an effort to diversify reserve holdings; raised the maximum amount of export earnings that are exempt from compulsory sale on the formal foreign exchange market; and extended the time-limit for foreign exchange operations from 210 to 270 days. This set of measures, which expanded the opportunities for external saving, constituted an acknowledgement of the structural changes that had taken place in the country's external accounts.

3. **Trends in the main variables**

a) Economic activity

The expansion of both private consumption (somewhat less than 4%) and exports (7%) contributed to the growth of economic activity. The effects of the adjustment were clearly visible in the slower growth (from 8% to under 3%) of domestic demand, which had been cooled down by the restrained increases in public spending (2%) and fixed investment (3.5%).

Economic activity was boosted by the recovery of tradable goods, particularly those linked to fishing, forestry and agriculture. Mining and industry grew by 3%, or less than total output; in mining, this was due o the decline of some subsectors, such as oil and coal, and in industry, to the cooling down of domestic demand. The industrial products wliich compete with imports (textiles, clothing, leather goods and footwear) contracted by between 6% and 10%, whereas industrial exports ma< le significant gains, notably fish meal (27%), tinned fruit, pulses and fresh produce (12%), methanol (8%) and cellulose and paper (6%). Construction was

[1] Between 1986 and 1994, the external debt/GDP ratio fell from 110% to 41%, and the net international reserv '.s/external debt ratio increased from 9% to 62%.

up only 2%, and that increase was due to public works-related projects, as private construction, both residential and non-residential, sagged as a result of the drop in domestic demand. From the third quarter onward, trade recovered, thanks to the upturn in consumer goods imports.

The most dynamic sectors were fishing (19%), transport and communication (9%) and agriculture and forestry (7%). The fishing growth was due to the increase in the catch for the production of fish meal and fish oil and to the higher productivity of salmon and trout farms. The performance of agriculture and forestry continued to be linked to the buoyancy of the export sectors, especially fruit-growing and silviculture. In contrast, traditional agricultural production, linked to annual crops, dropped slightly.

b) **Prices, wages and employment**

In 1994, for the first time in over three decades, the Chilean economy achieved a single-digit inflation rate (9%), thus reaching the target set by the authorities. One of the factors contributing to this achievement was de adjustment of domestic spending, aided by the policy of high interest rates which the Central Bank had applied since November 1992 and had begun to moderate only at the end of 1994. The intensity of the domestic spending effort is shown by the decrease in the annualized inflation rate for non-tradable goods and services from 18% in January to 12% in September. Other key elements were the downward trend in the exchange rate and the moderate rise in tradable goods prices.

Starting in August 1994, the annualized inflation rate, which had been stuck in the 12%-13% range for 20 months, showed a marked downturn; from October onward, it was measured in single digits. The adjustment process was based on the slower growth of more labour-intensive non-tradables, which was reflected in a rise in unemployment, from levels of under 5% during the last quarter of 1993 to 6.7% in the quarter ending in September 1994 (with average annual rates of 4.6% and 5.9%), and in a slower growth of employment opportunities. Job creation, which had grown at an annualized rate of 6% in the second half of 1993, plunged to 3.5% in the firs t quarter of 1994 and to 1% in the third quarter. The lower expectations of finding a jcb also cut the expansion of the labour force, which had been robust up to that point, to 3.4' í in the second quarter and only 0.7% in the thin 1 quarter (a 2.3% average annual rate).

The costs of adjustment wore paid by the labour market in terms of numbers of jobs, not prices. The rise in the unemplcyment rate, at a time of slower growth in the labour supply, was accompanied by a significant gain in the purchasing power of wages. At the beginning of the second quarter, annualizes nominal wage increases were in the 17%-18% range, dropping to between 13% and 14% in the last quarter. The average purchasing power of wages rose 4.5% in 1994, a somewhat higher increase than in the real minimum wage.

c) **The external sector**

The balance-of-payments deficit on current account exceeded US$ 1 billion and the capital-account surplus was more than US$ 4.2 billion. With an errors and omissions deficit of US$ 570 million, the overall balance-of-payments figure approached US $ 3.2 billion.

The current-account deficit fell to 2.4% of GDP (5.6% in 1993), thanks to the considerable improvement in the trade balance, which amply offset the slight deterioration in f inancial services and transfer payments.

In contrast to an initial prediction that the deficit would be virtually the same as in the preceding year (US$ 980 million), the merchandise trade balance closed with a surplus of US$ 660 million, since the growth in the value of exports (25%) was much higher than for imports (7%).

A strong recovery in the terms of trade was seen in 1994. Copper prices posted an average rise of 21%, while the December price represented an increase of 79% over the last-quarter average for 1993 Copper prices

Chile is now the world's second-largest producer of salmon and fish meal.

began to rise at the beginning of the year and gained unexpected strength during the second half of 1994.

Similarly, international prices for fish meal began to rebound during the last six months of 1994, while the average annual price of cellulose was up 47% over the previous year. Meanwhile, annual oil prices fell by 9%, generating favourable trade prices for oil- importing countries like Chile.

Merchandise exports reached US$ 11.5 billion, with an expansion of 25% in value and 9% in volume. The most dynamic exports were industrial goods (26%), led by metal products, electronics and transport equipment (33%) and food products and beverages (20%). The volume of mining exports rose 10% (although copper exports were up only 6%), as did primary products, with forestry (12%) and fishery (37%) exports playing a leading role.

Manufacturing exports grew by 15%, thereby accounting for over one sixth of total exports, with sales of more than US$ 2 billion.

The value of copper exports jumped 31%, driven by the 21% rise in international prices. Exports of other traditional products also expanded by 27%, with increases of 18% in value and 8% in volume. Bleached cellulose and methanol showed particularly large increases. Overall foreign sales of fish meal, physical gold and doré, oxide and ferromolybdenum, fresh fruit and raw cellulose were up nearly 20%.

The value of non-traditional exports grew 19% as the net result of larger shipped volumes (20%) and a slight drop in prices (-1%). Outstanding results were seen for agricultural, seafood and farm food products, wine and tobacco, planed wood and, in the electronics and transport sectors, copper wire and transport equipment.

The adjustment process intensified the slowdown in imports, whose growth rate in current dollars sank to 6% from 25% in 1992 and 10% in 1993. During the second half, however, imports began to recover, growing by 12%.

The increased buoyancy in the major export markets was reflected in exports to Latin America and Asia, which surged by around 30%. Exports to North America grew by 21%, and to the European Union, by nearly 12%. At the country level, exports to Russia increased by nearly 150%, although their initial level was fairly low, and exports to Thailand, by over 70%. The European recovery was seen in higher sales to Belgium (54%), Finland (46%) and Portugal (33%).

In 1994, one third of Chilean exports went to Asian countries, and another one c uarter (26%) to the European Union. Latin America accounted for 21% and North America for thï other 18%. The major market for non-copper exports was Latin America (27%). For coppor, the main market was Asia (46%), followed by the European Union (32%).

In recent years the balance-of-payments capital account has undergone significant changes. The average annual surplus increased from US$ 1.2 billion during 1987-1!>91 to almost US$ 3.6 billion during 1992-1994. Moreover, a steady decrease has been seen h short-term capital flows as a percentage of total capital income: 95% in 1989,67% in 1992,50% in 1993 and 28% in 1994. The structure of capital flows is shifting from foreign debt to foreign investment and venture capital and from short-term to long-term debt and pul lie to private debt. Thus, the restrictions on capitiil flows have apparently been effective in reducing the vulnerability of the Chilean economy to potential external shocks, as was evident aftei the eruption of the Mexican crisis at the end of 1994.

The capital account, excluding reserves, posted a surplus of more than USS 4.2 billion, equal to 9% of GDP, which made it possible to finance the current account and build up reserves totalling US$ 3.7 billion (8% of CDP). Capital inflows were concentrated in the last quarter, when they exceeded US$ 2.3 bilion, which increased the pressure on the excha lge rate.

Foreign investment (capital plus loans) increased by 70%, thus approaching US$ 4.7 billion, a new record figure equal to› 9% of GDP. Some US$ 2.5 billion (up 48%) flowed in under the provisions of Decree-Law 600 (62% in capital investments and the remainder in associated loans) and slightly over US$ 1.7 billion (up by almost 110%) througl ADR issues. Two thirds of the capital received under Decree-Law 600 went to mining, 14% to services and 13% to industry.

Net foreign investment, excluding associated loans, accounted for nearly 42% of capital flows. As in 1993, the main foreign investment modality continued to be portfolio investment, consisting almost entirely of net ADR revenue, which rose 65% to nearly US$ 1.4 billion.

Secondary ADRS -stock purchases on the local exchange and their subsequent conversion into ADRs negotiable on the New York Stock Exchange- brought in around US$ 620 million, while another US$ 750 million was received from primary ADR issues, i.e., stocks issued directly by foreign companies. At the end of 1994, ADR operations on the New York Stock Exchange totalled nearly US$ 3 billion, of which 30% was concentrated in a telephone company.

Net reserves increased by slightly more than US$ 3.7 billion, which brought the net total to around US$ 13.5 billion, an amount somewhat higher than one third of GDP and equal to nearly 15 months' worth of exports.

Chilean foreign investment continued to rise (to almost US$ 760 million, which represents around 1.5% of GDP. At the end of 1994, there were projects under way worth almost US$ 8.1 billion, to which domestic enterprises had directly contributed some US$ 3.25 billion. More than three quarters of this investment was in Argentina and Peru and 93% of the total was in Latin America. The target sectors include electricity, trade, banking and finance, private pension funds and insurance, printing and publishing, communication, services and information technology.

On 31 December 1994, tie foreign debt totalled US$ 21.6 billion, which was 12% higher than the figure of one year earlier. This was due essentially to the 23% increase in private debt, which came to almost US$ 2.4 billion.

In November Chile formalized its membership in the Asia-Pacific Economic Cooperation Council (APEC), wiile pursuing its negotiations to join the North American Free Trade Agreement (NAFTA).

ECUADOR

1. Gen trends

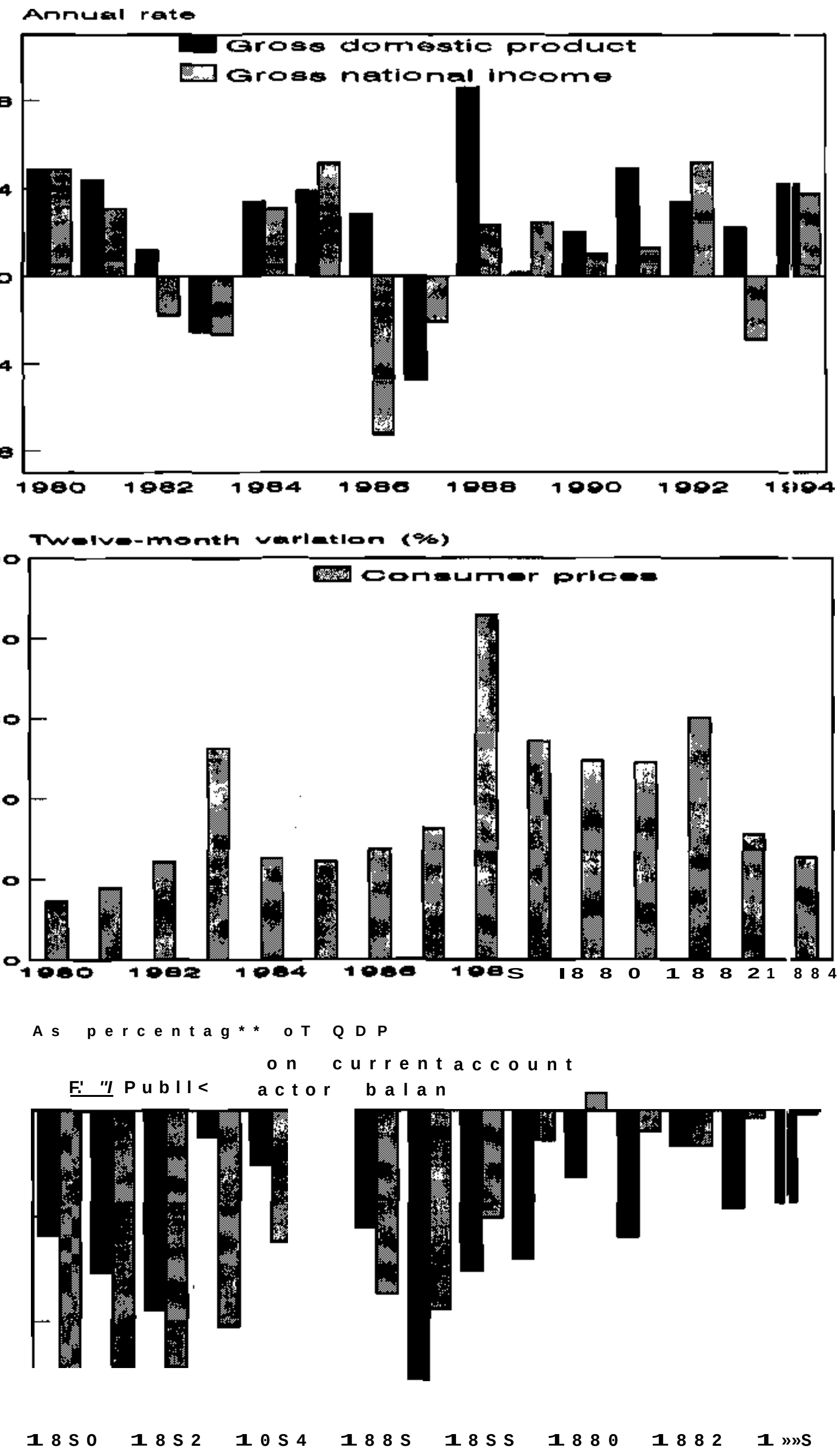
In 1994, the general course taken by Ecuador's economy was once again primarily determined by the economic programme which had been launched two years earlier in an effort to reduce inflation and introduce major reforms in the public, external and financial sectors. Whereas in 1993 -the first year of the plan's application- the contractive conditions characteristic of stabilization policies had predominated, in 1994 the economy's growth rate picked up to over 4% per annum, resulting in an increase in the country's per capita gross domestic product (GDP). The greater robustness of the economy stemmed from a rapid increase in domestic demand together with a substantial expansion of exports. Nevertheless, since imports were also up sharply, the current account deficit widened; this shortfall was more than covered, however, by Ecuador's abundant inflows of external resources (particularly long-term funds), which included a copious inflow of direct investments made under the new terms granted to investors in the petroleum industry, as well as in other areas of production. Attractive domestic interest rates and the relative stability of the sucre were also contributing factors in the country's short-term capital inflows. As a result, a marked increase (equivalent to about 2.5% of GDP) was seen in international reserves for the second year in a row.

Despite the reduction in petroleum revenues, the fiscal adjustment process made headway, and this was reflected in a reduction of the non-financial public-sector deficit to just 0.2% of GDP and the posting of a surplus by the consolidated public sector amounting to 0.4% of GDP. Such factors as the relative stability of the exchange rate (which, in the presence of a policy effort to open up an economy to external trade, has a direct impact on the price of tradables), the existence of balanced fiscal accounts and an increased demand on the part of the public for real money bala ices all made it possible to cut the annual inflai ion rate from 31% in 1993 to 25% in 1994, the lowest rate since 1985.

In the light of this favouralle economic situation, the Government designed an economic programme for 1995 which would seek to boost growth, achieve a small suiplus in the non-financial public sector and significantly reduce the inflation rate. However, the armed conflict which broke out with Pera early in the year led to changes in a number of key variables (capital inflows, public spending and interest rates) and forced the authorities to r. ut aside those objectives and to turn their attention to achieving GDP growth of between 3% and 3.¡¡%, striking a fiscal balance, holding the increase in the consumer price index (CPi) to between 19% and 21%, and carrying out a nominal devaluation of approximately 17% within a cirrency band having a spread of 100 sucres between its floor and ceiling rates.

The available indicators for the first months of the year revealed that up until May the fiscal deficit widened as a direct consec uence of the cost of the border conflict, while inflation remained slightly below the level recorded the year before. Exports grew rapidly during the first four months of the year, large ly as a result of higher oil prices. However, imports climbed even more steeply due, in psrticular, to purchases undertaken in connection with the above-mentioned conflict, and the country's trade surplus thus exhibited a tendency to shrink.

Figure 1
ECUADOR: MAIN ECONOMIC INDICATORS



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2. Econ ic policy

Economic policy continued to be geared towards reducing inflation by means of strict fiscal discipline, a devaluation in line with the targeted level of price variations and a monetary policy which sought to curb the expansionary effect of foreign capital inflows. Against this backdrop, in May a stand-by agreement was signed with the International Monetary Fund (IMF) in which targets were set for 1994 with respect to growth (+3%), the CPI (+20%), the consolidated public sector's deficit (0.5% of GDP) and an increase in international reserves (US$ 275 million).

Thanks to this stand-by agreement and the renegotiation of the foreign debt with commercial banks, which resulted in an agreement in keeping with the Brady Plan, the country's international financial relations returned to normal. Trade policy continued to promote trade integration and to deepen the country's integration both at the regional level (through the adoption of the Andean Group's common external tariff and the conclusion of an agreement with Chile) and at the world level (progress in negotiations regarding the possibility of Ecuador joining the World Trade Organization).

a) Fiscal policy

The fall in the price of oil had a severe impact on government income. After Congress rejected a proposal by the executive branch to increase the value-added tax (VAT) from 10% to 18%, a decision was taken to raise fuel taxes drastically. This measure was applied to petrol early in 1994 and to diesel fuel towards the end of the year. Consequently, the retail prices of these products matched their international price levels for the first time since Ecuador became an oil-exporting nation. Even so, the public sector's oil revenues still fell in real terms.

In addition, as part of the effort to lessen the country's dependency on earnings from the petroleum industry, steps were taken to broaden the tax base and improve the tax collection system by conducting a national census of taxpayers, passing legislation to reform existing tax laws and modernizing the customs service. Although the country still had a ling way to go in its drive to put a stop to tax evasion, a slight real increase was recorded in i ion-petroleum revenues, particularly from import duties and the value-added tax.

On the other hand, the surplus generated by State enterprises shrank in real teims, mainly as a result of the fact that some typ es of charges (e.g., communications and electricity rates) lagged behind prevailing price levels. Taken as a whole, then, the current income of the non-financial public sector declinei 1 in real terms.

In order to meet the target of reducing the fiscal deficit to 0.5% of GDP, the public sector implemented a policy of strict fiscal discipline; this led to decreases in both current expenditure (down from 19.4% to 17.4% of GEP) and capital outlays (down from 7.6% to 7% of GDP). In contrast, debt servicing rose to the equivalent of nearly 5% of GDP in 1994.

This policy of spending restraint was extremely successful in achieving its aim, so much so that the non-financial public-sector deficit narrowed by more than expected. Thus, if the Central Bank's surplus (which was mainly attributable to the low preferential exchange rate used by the Bank for making its payments to the State oil company, PETROECUADOR, for oil exports) is taken into account, then the consolidated fiscal balance showed a surplus of 0.4% of GDP.

b) Foreign exchange policy

Since 1993, a floating exchange rate -combined with Central Bank inter mention in the foreign exchange market- has been used for all external transactions. Within this framework, the selling rate for Central Bank transactions is calculated on the basis of the interbs nk exchange rate.

Up until November, the Central] Jank held the buying rate at 250 sucres below thî selling rate for the acquisition of the foreign exchange generated by oil exports. The spread was then maintained at 180 sucres for severa months, but was lowered to 150 sucres early in 1995.

Table 1
ECUADOR: MAIN ECONOMIC INDICATORS

	1987	1988	1989	1990	1991	1992	1993	1994[a]
				Growth rates				
Growth and investment								
Gross domestic product	-4.8	8.8	0.2	2.0	4.9	3.4	2.2	4.2
Per capita gross domestic product	-7.1	6.2	-2.2	-0.3	2.5	1.1	-	2.0
Gross national income	-2.1	2.3	2.4	1.1	1.3	5.2	-2.9	3.7
Gross domestic product by sector								
Goods	-11.6	15.2	-2.9	-0.6	5.0	3.5	2.8	5.9
Basic services	4.2	5.8	7.7	3.2	5.5	5.3	4.1	4.4
Other services	5.2	3.9	-3.7	2.5	3.8	2.4	2.9	2.4
				Percentages				
Contribution to growth of GDP								
Consumption	5.0	-2.8	1.3	-0.6	-0.3	0.7	1.5	2.4
Government	0.2	0.2	-0.3	0.2	-0.2	-0.3	-0.1	-0.3
Private	4.8	-3.0	1.6	-0.8	0.0	1.0	1.6	2.8
Gross domestic investment	-0.5	-0.6	0.4	-2.4	3.9	-0.2	-0.6	1.6
Exports	-5.4	8.5	-0.5	3.7	4.6	3.2	1.9	3.4
Imports	-3.8	3.7	-1.0	1.2	-3.4	-0.3	-0.5	-3.2
				Percentages of GDP				
Gross domestic investment	17.2	15.2	15.6	13.0	16.1	15.4	14.4	15.4
National saving	4.3	8.3	9.0	10.2	11.0	13.8	9.8	9.8
External saving	12.9	6.9	6.6	2.8	5.1	1.5	4.5	5.6
				Percentages				
Employment and wages								
Activity rate	57.3	55.3	56.3	48.8	56.8	58.9	58.0	55.6
Unemployment rate [e]	7.2	7.0	7.9	6.1	8.5	8.9	8.9	7.8
Real minimum wage (Index: 1990=100)	167.2	140.5	110.2	100.0	87.0	87.1	100.0	115.9
				Growth rates				
Prices (December to December)								
Consumer prices	32.5	**85.7**	54.2	49.5	49.0	60.2	31.0	25.4
Wholesale prices		**66.8**	80.1	45.5	48.0	54.7	39.2	18.2
External sector								
Terms of trade (Index: 1990=100) '	108.3	**96.5**	105.4	100.0	87.8	90.8	78.7	78.2
Nominal exchange rate (sucres per dollar)[8]	170	302	526	768	1046	1534	1919	2 197
Real effective exchange rate (Index: 1990=100)	78.8	92.3	94.6	100.0	95.2	94.7	84.0	78.4
				Millions of dollars				
Balance of payments								
Current account	-1304	**-708**	-691	-317	-652	-193	-660	-942
Trade balance goods and services)	-274	**440**	539	880	483	800	443	268
Exports	2 445	**2** 644	2 871	3 253	3 408	3 631	3716	4 462
Imports	2719	**2** 204	2 332	2 373	2 925	2 831	3 273	4 194
Capital account	1228	**683**	1070	717	809	215	1 132	1400
International reserves (variation)	-76	**-25**	379	400	157	22	472	458
				Percentages				
External debt								
Gross debt (as a percentage of GDP)	109.2	115.9	116.5	112.1	106.5	97.5	88.1	82.6
Net interest (on exports)	31.5	32.0	33.0	28.5	24.1	18.6	16.8	18.4

Table 1 (conclusion)

	1987	1988	1989	1990	1991	1992	1993	1994[a]
				Percentages of GDP				
Non-financial public sector								
Current income	21.9	21.5	26.3	27.1	25.4	25.8	26.6	24.1
Current expenditure	24.5	21.4	20.2	19.5	18.5	19.6	19.4	17.4
Saving	-2.6	0.1	6.1	7.6	6.9	6.2	7.2	6.8
Capital expenditure	7.1	5.4	7.5	7.5	7.9	7.9	7.6	7.0
Financial balance	-9.6	-5.3	-1.4	0.1	-1.0	-1.7	-0.4	-0.2
Domestic financing		1.8	-5.1	-3.3	-1.9	0.3	-2.3	-1.3
External financing		3.5	6.5	3.2	2.9	1.4	2.6	1.5
				Growth rates				
Currency and credit								
Monetary balance of banking system								
Net international reserves				217.0	35.2	6.0	48.7	20.2
Domestic credit			10.5	21.9	35.7	47.6	56.9	81.3
To the private sector			38.4	42.3	66.5	61.2	77.8	77.4
Money (Ml)			38.1	52.2	46.5	44.5	49.4	35.7
Savings and time deposits (in local currency)			52.0	77.4	71.4	60.7	52.2	64.3
M2			44.2	63.8	59.0	53.3	51.0	52.0
Dollar deposits					290.3	1 385.0	S 39.9	202.7
				Annual rates				
Real interest rates (annualized)								
On deposits		33.7	-13.7	-7.8	-4.7	-7.9	1.0	6.9
On loans		-27.8	-7.4	-3.7	-1.2	-1.7	13.2	15.1
Equivalent interest rate in foreign currency[1]		-25.3	-11.6	0.2	-1.9	4.1	17.6	11.6

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. Based on 1980 dollars at constant prices. [c] These entries measure the impact c f the variation in each aggregate on the variation in GDP. The coefficients were obtained by multiplying each aggregate's annuil growth rate by the level of that aggregate as a percentage of GDP. d Percentages of the working-age population. [e] Pi ¡rcentages of the economically active population. [f] Calculated on the basis of 1980 weightings. [g] Up to and includinj 1992, this entry refers to the exchange rate on the regulated market. From 1993 on, it refers to the exchange rate on the open mai Icet. Refers to net interest as shown on the balance of payments, divided by exports of goods and services. ' Interest rate on deposits, deflated by the variation in the exchange rate.

Table 2

ECUADOR: MAIN QUARTERLY INDICATORS

	1992				1993				l<94[a]			
	I	II	III	IV	I	II	III	IV	I	n	III	IV
Gross domestic product (Index: 1990=100)	107.9	109.3	109.1	108.7	110.1	110.3	111.9	111.6	112.7	113.4	117.3	118.3
Consumer prices (12-month variation)	46.7	50.4	61.1	60.2	56.1	52.2	35.5	31.0	31.6	26.5	26.2	25.4
Real exchange rate (Index: 1990=100)	95.5	91.0	94.4	98.0	89.8	84.2	82.4	79.5	79.1	77.4	78.5	78.5
Real interest rate (annualized)												
On deposits	-3.3	-10.7	-16.7	-0.8	-5.3	-6.9	15.0	1.3	-5.1	3.3	15.2	14.2
On loans	-2.1	-7.2	-11.1	13.6	10.1	1.9	28.0	12.7	3.9	11.6	23.4	21.5
Money supply (Ml) (12-month variation)	40.1	34.1	29.3	44.5	48.7	46.8	51.2	49.4	52.0	44.1	62.3	35.7

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures.

Beginning in 1994, the exchange rate applied to the Central Bank's internal accounts (390 sucres to the dollar) was discontinued.

In the course of the year, the sucre was devalued by 14% in nominal terms, which amounted to a real average annual rate of revaluation of approximately 7%. None the less, the real exchange rate remained stable during the second half of the year, which meant that the rate for the fourth quarter was only 1% lower than it had been at the end of the preceding year. This situation was the net result of the combination of a real revaluation with respect to the United States dollar and a real depreciation vis-à-vis the currencies of other trading partners, both in the region (Chile, Colombia) and in other areas of the world (Germany, Japan).

c) Monetary policy

Given this system of floating exchange rates, the heavy inflow of external resources which was precipitated by Ecuador's high interest rates prompted the Central Bank to intervene in the foreign-exchange market to prevent the local currency from appreciating too sharply. Accordingly, the Central Bank increased its international reserves, and the rate of money creation which this step entailed remained high throughout the year.

The non-financial public sector was able to keep its accounts virtually balanced while at the same time increasing its external borrowing. As a result, most of the expansion of the money supply caused by the rise in reserves was absorbed through an increase in the public sector's deposits, which was thus substituting external debt for domestic debt. Even so, since the demand for money grew as the inflation rate eased, the money supply swelled by some 36%.

The attractive interest rates offered on deposits in sucres triggered an increase of around 65% in local-currency savings and time deposits. The broadly defined money supply (M2) thus expanded by some 52%. Dollar-denominated deposits trebled, but continued to represent no more than a small percentage of total deposits.

In their attempts to engineer a drop in lending rates, the authorities reduced the cost of financial intermediation by lowering the bank reserve requirement applying to sight deposits from an initial 28% to 25%, and then to 10%; in addition, banks were no longer required to invest in low-yield government bonds. The growth in the money supply was accompanied by a heavier demand for loans, with tlie result that private-sector credit jumped by *'U%*, which was equivalent to a real rate of over 40%.

Enactment of the Omnibus Financial Institutions Act spurred the expansion and diversification of the capital market and simplified its supervision through the Superintendency of Banks. Activity on the stock exchange picked up, but at US$ 800 million, the total trading volume for the year was still quite small. As in the previous year, mi >st of the trading was in common stock.

d) Trade policy

Trade received a major boost from the lowering of tariffs and the establishment in October 1992 of a free trade area among the Andean Group countries. The Government of Ecuador continued its efforts to carry forward the economy's integration into regional and world markets in 1994. Thus, on 31 ianuary 1995, a Common External Tariff (CET) came into effect for Colombia, Ecuador and Venîzuela. The CET is comprised of four tariff levels: 5% for primary products; 10% for semi-processed goods; 15% for intermediate goods; and 20% for final products, with the exception of motor vehicles, where the applicable tariff rate is 35%. The CET was to take full effect as of 31 December 1995. Exceptions to the CET were dîtermined on a country-by-country basis. In the case of Ecuador, exceptions were granted for 400 sub-items, but these exemptions were to be phased out over a four-year period.

In other developments, progr;ss was made in negotiations regarding Ecuador s entry into the World Trade Organization (W o>, which was expected to take place some time, in 1995. Bilateral negotiations were also pursued with a view to strengthening Ecuador's trade links with a number of countries, including Chile, Cuba, the Dominican Republic and Mexico. Meanwhile, multilateral talks between States members of the Andean Pact and of MERCOSUR made headway.

In late 1994, Ecuador and Chile signed an economic complementarity agreement which called for a step-by-step removal of tariff barriers.

e) **Structural reforms**

In order to improve market efficiency, a number of regulations that had hindered external trade, domestic commerce and price formation were rescinded. In addition, various laws of a sectoral nature were enacted: the Omnibus Financial Institutions Act, which was designed to make the financial market run more smoothly; the Customs Act, which simplified customs formalities and opened the way for the authorities to award port and customs service concessions to private-sector interests; and the Agricultural Development Act, which superseded agrarian reform laws, placed strict limits on expropriations and streamlined land-related transactions. This law sparked severe social conflicts which gave rise to serious confrontations.

In 1994, the Government announced its Strategic Programme for the Modernization of the State. The Programme's main objectives included the following: rationalization of the State apparatus and of the Government's role in the economy; greater government efficiency; promotion of broad-based equity ownership among the citizenry; and the promotion of investment through privatization. Implementation of a staff-reduction scheme for public-sector institutions continued. This scheme, under which employees were offered compensation in return for their voluntary separation from the civil service, was taken up by some 20,000 public employees.

Congress exempted the petroleum, electricity and telecommunications sectors from the types of privatization operations governed by the State Modernization, Privatization and Provision of Utility Services by Private Enterpr se Act, which entered into effect in 1994. In this same connection, the Government drew up a package of proposed reforms of the Constitution; this package was approved in a ref;rendum and submitted to Congress. The proposed reforms would, *inter alia*, broaden the powers of the executive branch in matters pertaining to public spending and streamline privatization processes in the mining, energy, telecommunications and social security sectors. Final approval of the principal reforms was contingent upon the outcome of negotiations between the executive and legislative branches.

The process of privatizing the national airline, Ecuatoriana, was begun in 1994 wit li the airline's conversion into a stock corporation and the determination of the privatization procedures to be followed. Other measures design ;d to increase the role of the private sector included the ready access offered to prospective investors in new activities such as the expansion of the trans-Ecuador oil pipeline and tie award of concessions for the provision of such public services as signposting and maintenance of motorways, customs services and rubbish collection in Guayaquil. The process of reducing the number of production enterprises in State hands was also carried forward wii h the sale of the Government's share in one of ihe country's cement plants.

In an effort to offset the social effects of the adjustment programme, the Emergency Social Investment Fund entered into operai ion. The aim of this Fund was to finance project!! in the areas of infrastructure, social services and institution-building as well as to set up revolving funds. The Fund had a total of USJ 120 million at its disposal, most of which was provided from overseas sources, and was expected i o operate for a period of four years. As of the end of 1994, 2,300 projects involving a total of U! >$ 44 million had been approved.

3. **The main variables**

a) **Economic activity**

GDP grew at a rate of 4% per annum -about double the rate recorded the year before- while per capita GDP expanded by some 29 i, which was close to the all-time high reached in 1981. The growth of exports and private consumption paved the way for the 6% increase registered in total demand, while public consumption continued on a downward trend which had already lasted for several years.

Gross domestic investment's share of GDP rose to more than 15%, thus rebounding to the level it had reached two years earlier. The growth rates for public- and private-sector fixed capital formation were similar, but the bulk of the increase in this variable was attributable to the private sector, given its large share of the total. Most of these investments were in machinery and equipment, although there was also considerable investment in the construction sector. The expansion of investment was financed with external savings, while national saving remained at around 10% of GDP.

Manufacturing, construction and mining (especially of petroleum) all recorded marked growth in real terms. Financial services, commerce and basic services grew at much the same rate as overall output. The increase in petroleum production was a result of the opening of new oil fields which were to be developed by foreign companies; in addition, the seventh round of tenders for oil prospecting took place, leading to the award of leases for the exploration and development of seven new tracts to international consortiums. In view of the fact that the trans-Ecuador oil pipeline was approaching full capacity, the initial steps were taken to call for tenders for the pipeline's expansion (at an estimated cost of US$ 600 million).

Growth in the rest of the manufacturing sector sped up, with particularly notable increases in non-metallic minerals and basic minerals, textiles, wood, paper and printed matter, chemicals, and machinery and equipment. A number of these activities have benefited from increased exports to other member States of the Andean Group and from foreign direct investment in recent years.

After experiencing a period of contraction, construction staged a significant recovery thanks, in particular, to the boost it received from external funds. The process of modernizing the financial sector, which had been initiated several years earlier, was given a fillip by the enactment of the Omnibus Financial Institutions Act, while increased private consumption, combined with closer external trade links, had a favourable impact on trade. Among the bisic services, a particularly strong performance was turned in by the transport, storage and communications sector, which expanded as a result of increased commercial activity.

After the downturn of the preceding year, agricultural production rose slightly in 1994; notable increases were register© 1 in such major crops as bananas, coffee, African palm, rice, potatoes and flowers, as well as livestock. Banana production increased significantly, despite the expected decline in the area harvested, which was encourage 1 by the offer of compensatory payments. In the case of coffee, favourable prices provided an incentive for the use of improved farming techniques and the harvesting of the entire crop. In œntrast, fishery production declined yet again, due, among other factors, to recurring problems in the shrimp industry, including the affliction which has come to be known as the "Taura syndiome".

Lastly, community, social and personal services registered a decrease owing to the persistent contraction of government services.

b) **Prices, wages and employment**

The economic programme in force was backed up by the relative stability of the exchange rate within a context marked by the liberalization of trade and a cautious fiscal policy. This meant that inflation continued to slow down even though various factors were pulling the rate in the opposite direction; these factors included the introduction of fuel price hikes for fiscal reasons, growing demand for consumer goods and increased money creation. The rise in the CPI for the year came to around 25%; although this figure excîeded the 20% target set down in the country's agreement with the IMF, it was nevertheless below the 31% level recorded in 1993.

In order to compensate for these higher price levels, the fringe benefits and supplementary allowances provided to persons earning the minimum wage were adjusted in January; in July, further increases were made in I hese benefits as well as in the minimum living wage. Overall, these wage hikes represented a real increase of 16% in the minimum living wage (including fringe benefits) and thus constituted one more step in these wage levels' partial recovery from the substantial losses of purchasing power sustained in the 1980s and early 1990s.

The average income of the working population increased by 4% in real terms. However, a polarization of labour income levels was to be observed. Wage-earners in medium-sized and large firms (except in the construction industry) located in urban areas witnessed a rise of almost 9% in their real average remunerations, but workers in the urban informal sector saw their earnings increase by a bare 3%.

The urban unemployment rate fell from 8.9% to 7.8%. This positive change was due, firstly, to a considerable reduction in the overall urban participation rate and, secondly, to a slight increase in the number of jobs. This was concentrated in the formal sector, where there was a notable rise in paid employment in construction, commerce and, to a lesser extent, community, social and personal services; industrial employment levels were down, however. Nevertheless, not all areas experienced a decrease in unemployment, since the level of unemployment actually rose in Guayaquil.

Mention should be made in this connection of the projects begun in 1994 under the aegis of the Emergency Social Investment Fund. Although these projects may have been of minor importance in quantitative terms, they were nevertheless successful in creating some temporary jobs. Employment in the urban informal sector dropped slightly, and this was reflected in a slight reduction in the rate of underemployment; consequently, 46.2% of the economically active population (EAP) in urban areas was classified as being underemployed in 1994, as compared to the 47.7% figure recorded in 1993.

c) **The externa] sector**

After a lackluster performance in 1993, exports of goods increased by some 21%; all the main export products shared in this growth. Earnings from petroleum sales were adversely affected by very low prices early in the year, and even though prices recovered somewhat in the final two quarters, their average level for 1994 was still the lowest to be recorded in the last six years. Nevertheless, because export volumes were up, the total value of the petroleum industry's external sales (including petroleum products) climbed by 4%, bringinj; this sector's share of total exports to about 3:>%. Even so, petroleum exports remained below their 1992 level.

Ecuador managed to increasî its banana exports by about 15%, notwithstanding the quotas established by the European Union for banana imports from various group i of countries. This increase reflected both a growth in sales to countries belonging to the Eure pean Union, thanks to the direct contacts established with importers, and greater access to new markets, especially in Eastern Europe. However, the specific quota agreements signed by the European Union and a number of banana-producing countries, which were slated to take effect in 1995, may have ¡;ome adverse effects on Ecuador in the future.

The value of coffee exports incre ased fourfold due to higher prices and a larger harvest. The volume of shrimp sales decreased yet again, but higher prices meant that the vahe of exports actually rose by 14%. Exports of cocoa, fish and non-traditional agricultural products (flowers, fruits and vegetables) climbed significantly, as did external sales of industrial products, including most processed agricultural products as well as metal, textile, chemical and pharmaceutical manufactures. Siles of these items exhibited a sharp increase over their 1993 levels, largely as a consequence ol' the creation of the Andean Group free trade area. Non-traditional exports were up by 28% as a whole, for a total value of US$ 661 million.

The higher growth rate for exports was a reflection of the demand genet ated by the European Union, the Andean Groip (especially Colombia) and several other Latin American countries, particularly Chile and Mexico. The tourism sector continued to expand as it marked up a growth rate of 10%, thus becoming the country's fifth most important source of foreign exchange.

Imports of goods (c.i.f.) were up by about 42%, which was higher than the growth rate for exports. This expansion was seen across the board, but was especially remarkable in transport equipment (118%), fuels and lubricants (93%), durable consumer goods (49%) and non-durable consumer goods (44%). Smaller increases were recorded in the categories of capital goods (8%, excluding transport equipment) and inputs for agriculture and industry (32%).

The bulk of this expansion was accounted for by imports from the Andean Group countries and the other States members of the Latin American Integration Association (ALADI) (particularly from Brazil and Mexico), which exhibited growth rates of 176% and 105% respectively. As a result of this steep increase, Ecuador's 1993 trade surplus with ALADI, and specifically with the Andean Group, gave way to a deficit in 1994. In contrast, the upturn in some traditional exports to Europe made it possible for Ecuador to mark up a trade surplus with that continent, after having recording deficits in previous years.

Ecuador's merchandise trade balance slipped from the US$ 588 million figure recorded in 1993 to US$ 445 million in 1994. Since the country's deficit in non-factor services widened slightly, its overall trade surplus shrank from US$ 443 million to US$ 268 million. Moreover, due to higher payments for factor services, the current account deficit jumped from US$ 660 million to US$ 942 million (the equivalent of around 5% of GDP).

On the capital account, the level of foreign direct investment was quite high (US$ 530 million) for the second year in a row. These investments were primarily channeled to the petroleum sector, although since 1993 the amount of foreign direct investment in non-petroleum-related activities has also been rising. Other major sources of capital inflows included increased official-sector lending, import credits and the short-term capital that was attracted by high interest rates. The decision to use Global Depositary Receipts (GDRS) as a vehicle for offering shares in one of the country's cement companies on the United States stock exchange marked the first time ever that stock in an Ecuadoran firm had been traled outside the country. All told, the inflow of external resources was more than sufficient to oflset the current account deficit and thus served to build up the country's international reserve!! by US$ 458 million to the unprecedented level of over US$ 1.7 billion.

By the end of 1994, the external debt had mounted to nearly US$ 13.7 billion, which was an increase of almost 7%. In October 1994, Ecuador signed a Brady-style agreement to restructure its external debt with commercial banks (US$ 4.5 billion of principal, US$ 2.3 billion in interest arrears and US3I 800 million in penalty interest). The principal could be exchanged either for discount bonds (with the discount amounting to 45%) having 30-year maturity and grace periods at 13/16% over LIBOR, or for par bonds, which a so had 30-year maturity and grace periods but carried interest rates that would gradually increase from 3% to 5%. Approximately 58% of the creditors opted for the discount bonds and 42% for the bonds at par. The bulk of the interest payments were to be made over a span of 20 years with a 10-year grace period at rates equivalent to 13/16% over LIBOR. Broadly si caking, it was estimated that the rescheduling package translated into a reduction of around one third in the country's commercial debt. In order to finance the restructuring of hi; debt -which entailed the purchase of United States Treasury zero-coupon bonds- Ecuador rea ived assistance from the International Monetary Fund, the Inter-American Development Bank, the Government of Japan, the Andeai Development Corporation, the Latin Americar Reserve Fund and the World Bank, with which it signed a structural adjustment agreement. Ecuador also proceeded to renegotiate its debt with the countries of the Paris Club; the corresponding agreement was to cover the refinancing of debt principal and interest payments corresponding to the period from 1 January 1993 ta 31 December 1994.

EL SALVADOR

1. General trends

In 1994 El Salvador's economy once again expanded at a satisfactory rate, albeit somewhat more slowly than during the preceding two years. Apart from strictly economic factors, production and investment once again reaped the benefits of the progress being made towards peace. The presidential elections, which led to a changeover of governmental authorities, had no more than a passing effect on economic trends. In the external sector, marked price increases were seen in merchandise exports, and the continuing rise of transfers into the country by non-residents contributed to the growth of national income.

The gross domestic product (GDP) expanded by 4.5%, thus rounding out five consecutive years of growth in per capita GDP. Every major component of expenditure was up sharply; fixed investment and the volume of exports of goods and services both expanded by over 10%, while consumption rose by around 6%, thereby further weakening the already meagre rate of domestic saving. In contrast, an improvement was to be observed in national saving owing chiefly to the increase in transfers frorri abroad. External saving declined as a percentage of GDP, although it was still above 5%. With the exception of agriculture, which contracted once again, all the principal sectors of activity expanded. Nevertheless, the rate of job creation was not high enough to drive unemployment below the 9% mark.

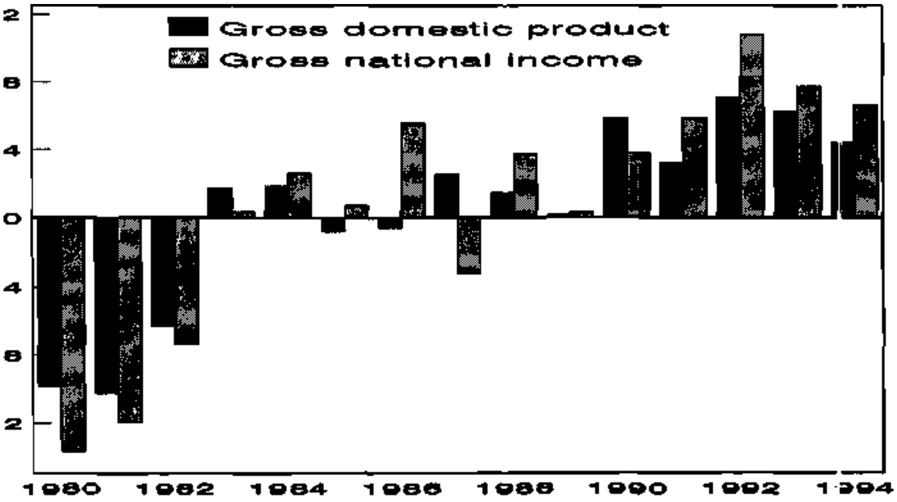
The central government surpassed its 2.5% deficit-reduction target by an ample margin, bringing the deficit down to just 2% of GDP. This result was attributable to both a rise in tax receipts and a drop in capital expendiiure. Central Reserve Bank credit to the public sector contracted during 1994; althougi the money supply expanded due to the build-up of reserves, the rise in liquidity was controlled through the extension of bank reserve requirements to include foreign-currency deposits *i* nd the sale of Monetary Stabilization Certificates (CEMs). Against this fiscal and monetary ba :kground, the exchange rate rose quite slowly, wh ich translated into a further appreciation of the colón in real terms, and the 12-month rate of cc nsumer price increases slowed to slightly under 9% in December.

Merchandise exports were stimulated by improved international prices, though the pace was slower than during the precedin g year. At the same time, however, merchandise imports also expanded, and the trade deficit therefore widened. This was offset by a higher surplus on the real services account, thanks ;o the robust upturn in exports of these services and, in particular, to the growth of private transfers. Consequently, the deficit on the balance-of-payments current account remained at US$ 300 million, or around 3% of GDP. Thî deficit was easily covered by the funds flowing into the country through the capital account, especially in the form of unrequited official transfers and external financing for the public sector. The dollar value of the public sector's foreign debt rose slightly, owing in part to changes in the exchange rates of the currencies in which El Salvador's debt is denominated.

2. Economic policy

The country's economic policy objectives for 1994 were to consolidate its macroeconomic adjustment, speed up economic growth, cut inflation and consolidate its reforms in public

Figure 1
EL SALVADOR: MAIN ECONOMIC INDICATORS



Twelve-month variation (%)

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1880 1882 1 88<4> 1888 1OSS 1OOO 1002 100<4

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finances and the financial system in order to backstop the expansion of exportable supply and to increase national saving and investment in production activities. The authorities who took office at mid-year revised the targets for the period in question and began to work on modifying the country's economic policy. Announcements made in February 1995 heralded a further opening of the economy through more rapid tariff reductions and the establishment of a fixed exchange-rate system.

a) **Fiscal policy**

The non-financial public-sector deficit (prior to the calculation of the level of grants and donations) shrank substantially in nominal terms, and the public sector's financing requirements were down from 3.6% to 2% of GDP. Saving reached the same figure (up from 0.7% in 1993) and thus covered almost half of capital expenditure. The rise in public-sector saving resulted from a substantially higher level of current income, while the rate of increase in public-sector spending slightly exceeded that of GDP. At the same time, capital expenditure contracted in real terms and the public sector took in revenues amounting to nearly 0.3% of GDP from the sale of some of its assets. The public-sector deficit was covered entirely by external resources, since, as planned, the Government paid off loans taken out on the local market. Grants and donations totalled less than they had the year before, but even so they accounted for two fifths of the total net external financing received by the public sector (and were equivalent to somewhat more than 70% of the deficit).

The across-the-board increase in the public sector's current income (30%) was, in the aggregate, higher than had been projected. Non-tax revenues and the operating surplus marked up by public enterprises exceeded the original targets; in contrast, the rise in tax revenues, although considerable (23%), was less than expected, and this placed some constraints on the Government's spending programme.

The taxes displaying the most significant trends were the income tax, the value-added tax (VAT) and import duties. In connection with the income tax, the principal compon ;nts of the tax base were revised and steps vere taken to institute a withholding scheme fcr a portion of the taxes levied on earnings from coffee sales. April's fiscal reform did away with the wealth tax. Then, in September, the estimated tax payments to be made in advance b; ' own-account professionals were raised from *2%* to 10% while the tax on gross corporate income v'as hiked from 1% to 1.5%.

Since its introduction in 1992 the VAT has become the most important single tax, generating over two fifths of total tax receipts. In addition, the momentum exhibited by imports led to a disproportionately large increase ir receipts from customs duties as remaining custou is exemptions were discontinued. At the same time, taxes on exports were almost completely el iminated.

The level of taxation rose to nearly 11% of GDP; this was one half of a percentage point above the 1993 coefficient, but war. still far from the levels of the mid-1980s. Duiing 1994 the measures adopted to improve tax administration, cut down on tax evasion and broade n the tax base began to have an impact. Nevertheless, at year's end the prevailing view was that ta:c evasion was still widespread and that revenues could be increased through better enforcement.

The most notable developments in terms of other sources of current income were the increased level of social security contributions and, in particular, the expansion of the operating surplus posted by public-sector enterprises. This surplus swelled to 1.4% of GDP (from 1% in 1993), partly as a result of rate adjustments (in the case of the energy sector, rate s climbed by 30%).

Capital revenues rose consideribly. In 1994 some of the facilities of the San Bartolo free trade area were sold off, as were assets of the Salvadoran Coffee Institute. The Salvadoran Institute for Agrarian Change (isrA) divested itself of a portion of its assets in compliance with the special assessment applyinj; to it as a contributor to the land-transfer programmes outlined in the Peace Agreement. Th e Legislative Assembly also passed a law on the privatization of sugar refineries and alcohol prod uction plants as a first step towards selling off these facilities during 1995.

Table 1
EL SALVADOR: MAIN ECONOMIC INDICATORS

	1987	1988	1989	1990	1991	1992	1993	1994'
				Growth rates				
Growth and investment								
Gross domestic product	2.5	1.4	0.2	5.8	3.2	7.0	6.2	4.4
Per capita gross domestic product	0.8	-0.4	-1.7	3.7	1.1	4.7	3.9	2.1
National income	•3.2	3.7	0.3	3.8	5.8	10.8	7.7	6.6
Gross domestic product by sector								
Goods	2.6	0.9	0.7	4.4	2.3	8.4	2.4	2.0
Basic services	1.9	2.0	1.1	6.2	5.2	8.8	9.6	7.8
Other services	2.5	2.0	-0.8	7.4	3.2	4.2	3.9	5.7
				Percentages				
Contribution to growth of GDP [c]								
Consumption	–	2.0	1.6	4.1	2.3	5.1	5.7	5.1
Government	0.5	0.5	-0.2	-7.1	0.3	0.1	0.1	0.3
Private	•0.5	1.5	1.8	11.2	2.0	5.0	5.5	4.8
Investment	•0.6	2.4	3.9	-3.0	2.6	4.8	1.9	1.6
Exports	3.2	-3.1	-3.5	6.3	•0.4	2.1	5.2	3.2
Imports	•0.1	0.1	-1.9	-1.5	•1.3	-5.0	-6.5	-5.6
				Percentages of GDP				
Gross domestic investment	12.8	**15.0**	**18.8**	**14.9**	16.9	20.3	20.9	21.6
National saving	7.0	8.5	7.2	6.5	9.5	14.1	15.4	16.5
External saving	5.8	6.5	**11.6**	8.4	7.5	6.2	5.5	5.1
				Percentages				
Employment and wages								
Activity rate					51.6	52.2	. . .	. . .
Open unemployment rate [e]					8.7	9.9	...	9.0
Real minimum wage (Index: 1990=100)*	132.2	125.2	106.3	100.0	97.8	101.0	97.8	99.8
				Growth rates				
Prices (December to December)								
Consumer prices	19.6	18.2	23.5	18.3	9.9	19.9	12.3	8.9
Wholesale prices	5.6	4.6	11.6	22.5	-1.2	9.6	2.6	11.9
External sector								
Terms-of-trade (Index: 1990=100)	111.6	120.2	115.5	100.0	98.2	94.9	97.9	99.4
Nominal exchange rate (Colones per dollar)	5.00	5.00	5.48	7.69	8.08	8.44	8.70	8.74
Real exchange rate (Index: 1990=100)	99.7	86.9	82.8	100.0	98.4	98.2	87.4	82.8
				Millions of dollars				
Balance of payments								
Current account	-223	-273	-511	-381	-369	-337	-299	-302
Trade balance	-307	-362	-624	-582	-712	-944	-1008	-1210
Exports	910	942	815	880	903	974	1 138	1 329
Imports	1217	1305	1 438	1462	1615	1918	2 146	2 539
Capital account	304	253	614	535	299	429	411	445
International reserves	74	-25	156	149	-128	135	114	143
				Percentages				
External debt								
Public debt (as a percentage of GDP)	36.4	29.7	32.8	37.6	34.4	34.0	26.0	23.9
Net interest (as a percentage of exports)	8.2	8.6	7.0	10.9	10.1	7.9	8.1	4.7

Table 1 (conclusion)

	1987	1988	1989	1990	1991	1992	1993	1994[a]
			Percentages of GDP					
Non-financial public sector								
Current income			10.3	12.5	13.0	13.6	13.7	15.2
Current expenditure			11.8	12.8	13.8	13.4	13.0	13.2
Saving			-1.5	-0.3	-0.8	0.2	0.7	2.0
Capital expenditure			4.3	2.5	4.1	6.7	4.3	4.0
Financial balance			-5.8	-2.8	-4.9	-6.5	-3.6	-2.0
Domestic financing			2.6	-1.1	0.8	0.6	-0.3	-1.5
External financing			3.2	3.9	4.1	5.9	4.0	3.5
			Growth rates					
Currency and credit								
Monetary balance of banking system								
Net international reserves			69.6	92.6	1.7	26.1	13.7	10.4
Net domestic credit			-32.6	10.4	22.7	37.5	45.5	27.4
To the public sector			-28.1	37.5	23.2	14.3	3.8	-27.8
To the private sector			12.3	6.2	12.8	31.0	37.5	27.2
Money (Ml)			12.8	22.1	6.1	31.8	12.4	13.7
Savings and time deposits (in local currency)			-19.5	32.0	29.1	31.2	48.6	25.3
M2			-8.7	27.9	20.0	31.4	35.9	22.0
Dollar deposits				66.2	-32.6	56.4	-1.4	39.9
			Annual rates					
Real interest rates (end of year)								
On deposits						-4.84	1.51	3.90
On loans						-1.41	5.80	9.50
Equivalent interest rate in foreign currency						-5.05	1.45	3.90

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. Based on 1980 dollars at constant prices. [c] These entries measure the impact oi the variation in each aggregate on the variation in GDP. The coefficients were obtained by multiplying each aggregate's annual growth rate by the level of that aggregate as a percentage of GDP. Percentages of the working-age population. [e] Pe-centages of the economically active population. Real minimum wage in manufacturing and service sectors in San Salvadoi. [g] Refers to net interest as shown on the balance of payments, divided by exports of goods and services. Interest rate on d îposits, deflated by the variation in the exchange rate.

Table 2

EL SALVADOR: MAIN QUARTERLY INDICATORS

	1992				1993				1994[a]			
	I	II	III	IV		II	III	IV		II	III	IV
Consumer prices (12-month variation, %)	7.6	7.2	14.5	19.9	21.2	23.4	15.0	12.3	12.9	9.9	9.6	8.9
Real exchange rate (Index: 1990=100)	98.4	100.0	99.0	95.2	91.7	89.6	84.5	83.7	82.4	82.8	83.5	82.6
Real interest rate (annualized, %)												
On deposits	3.80	0.80	-23.40	-6.00	5.30	-2.80	4.60	4.20	0.40	6.10	4.50	5.70
On loans	8.90	4.10	-20.20	-3.00	8.20	0.60	8.80	8.50	4.50	10.80	9.80	11.70

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures.

The expansion of nearly 18% seen in the level of public-sector current expenditure was within the projected range. Civil servants received pay raises; staff were recruited for institutions involved in the implementation of the Peace Agreement (the National Civil Police and the Office of the National Counsel for the Defence of Human Rights); and compensation was paid to demobilized members of the Armed Forces and National Police. Expenditure on health and education was also increased.

Capital expenditure was 20% below the target figure. The original public investment programme, which had been only partially completed the year before, provided for a volume of physical works which outstripped the sector's performance capacity; in addition, resource transfer procedures were modified, leading to a lower level of expenditure than expected. Although more attention was devoted to social sectors than in the past, three fifths of total investment still went to the energy sector, telecommunications, water supply systems, transport and storage facilities.

b) **Monetary policy**

While growth in the means of payment (13.5%) was somewhat higher than in 1993 (12.5%), the expansion of local-currency liquidity slowed, with the increase in M2 dropping from 36% to 22%. Time deposits were the best-performing component of this aggregate in 1994, indicating that the interest rates being offered proved attractive to savers. Dollar deposits also showed a substantial gain (40%), though their share of the total volume of broad money (M3) amounted to only just over 5%.

The expansion of the monetary base (19%) was particularly influenced by the build-up of international reserves, which accounted for more than 80% of total primary money creation during the year. The Central Reserve Bank expanded its domestic credit by less than 11% as, in net terms, many public-sector loans were paid off. Much the same sort of situation was to be observed in the financial system as a whole, with the net contraction of credit to the public sector amounting to 28% as a result of debt amortization and the rise in public-sector deposits. The expansion of liquidity was therefore fueled by private-sector loans (which were up 27%) and, to a lesser extent, by the increjse in foreign-currency reserves.

The main objective of monetiiry policy was to regulate the volume of liquid a ssets in order to promote the stabilization of pi ices and of the exchange rate. In April the revised charter of the Central Reserve Bank (BCR) was approved. Under the new provisions, the BC R was to confine itself to its functions as a central bank and to relinquish those related to the granting of credit. In addition, as of 1996 the Bank would no longer be permitted to finance the government treasury. In July the Multisectoral Investment Bank was created to take over the BCR'S credit lines and portfolios; the BCR then proceeded to put an end to rediscounting operations, maintaining a credit window only for immediate liquidity.

During 1994 the legal rese-ve requirement remained at 20% for time deposits and 30% for sight deposits; in September, a 10% reserve requirement was introduced for ioreign-currency deposits. A portion of these mandatory reserves, equivalent to what is in effect i 5% surcharge, bears interest. The BCR continued to engage in open-market operations through its issuance of Monetary Stabilization Certifiâtes (CEMs). In August an agreement was concluded under which financial institutions would hold 2% of their financial assets in CEifc, which was tantamount to a rise in the interest-bearing portion of their required reserves. These certificates, which are exempt from income tax and VAT, gradually took on grealer importance as instruments of monetary policy, although these sterilization measures weie not free of quasi-fiscal costs. Stabilization bonds accounted for almost 10% of the aggregate amount of money plus quasi-money in 1994. The circulation of these instrument! was, however, apparently confined to a small {¡roup of holders. In addition, there was a shift in demand towards longer-term (six-month and one-year) CEMs.

In November the central government issued Treasury Notes (LETES) for the ïrst time ever in an effort to augment its supply o f resources in the short run. The attractive yields of these notes encouraged the redemption cf other Central Bank securities as they matured, and the outstanding balance of these other instruments had therefore fallen by the end of the year. At the same time as the LETES were issued, the requirement that banks invest in CEMS was lifted.

Bank interest rates were higher than inflation. Nominal yields on time deposits weakened slightly in the second half of the year, but this was not true of the rates applying to loans, which actually rose in some banks. As a result, the spread between the interest rates on loans and deposits had widened to nearly six points (in terms of annual rates) by the end of the year.

c) **Exchange policy**

Sustained foreign currency inflows meant that in the first three quarters the exchange rate against the dollar varied only slightly. In September, when the flow of foreign exchange diminished, the BCR intervened in the market; as a result, the exchange rate held at a level only slightly above where it had been at the start of the year. The average value of the dollar for the year was 0.5% higher than in 1993, for a real appreciation of some 5% in the effective exchange rate. The introduction of a fixed exchange rate of 8.75 colones to the dollar (the rate in effect during the last quarter of 1994), together with full convertibility, proved to be one of the most prominent components of the new economic plan for 1995 and sparked a heated debate as to its potential impact on inflation and the real exchange rate.

d) **Trade policy**

The working meetings held in connection with the framework convention which the Central American republics had signed with Colombia and Venezuela in 1993 had still not resulted in any specific proposa. Steps were taken, however, towards an agree: nent with the Dominican Republic, and a trade a] jreement with Ecuador was ratified. In the context of negotiations with Mexico, techa'.cal meetings with Guatemala and Honduras -lhe other two members of what has come tc be known as Central America's Northern Triangle- proceeded during the first half of ti e year. These meetings were later held on a bilateral basis. Nevertheless, towards the end of 1)94 the thrust of Salvadoran trade policy shifted as priority was placed on the country's attempt to arrive at an arrangement similar to the North *A* merican Free Trade Agreement (NAFTA). This new trade policy also provided for a more rapid lib îralization of the economy from 1995 on; tariffs, which had been slated to remain within a 5%-20% range, were to be reduced to rates of between 1% and 6% over the next five years.

During 1994 El Salvador took action under GAIT provisions to counter measures that were affecting its trade. One specific ou :come of this effort was that the Textiles Surveillance Body found in favour of El Salvador, which had appealed against the attempts made jy the United States to impose a quota on Salvat oran exports of cotton and synthetic shirts.

With regard to the country's tiade in basic grains, in the final quarter the system of price bands used in setting variable import duties was discontinued, whi:h affected the Central American process of tariff harmonization for these products. One of the immediate effects of this step, which was announced during the harvest, was a drop in producer prices. At the same time, authorization was granted for the establishment of the Agricultural Products Exchange as an auxiliary credit hstitution.

3. **The main variables**

a) **Economic activity**

Overall demand increased significantly (7%), though less sharply than in the preceding two years. The volume of exports of goods and services rose by 11% (20% in 1993) while domestic demand slowed from 7% to 6%. The fastest-growing component of domestic spending was fixed investment, which expanded by 12%. The increase was particularly steep in investment in machinery and equipment. Substantial amounts of transport eqi ipment were imported while, among machinery imports, one particularly noteworthy acquisition was the purchase of a power plant by a private firm; the electricity generated by this plant is to be distributed by the State-run power company. Private construction was stimulated by housing projects in the western part of the country and by the renovation of commercial infrastructure in the metropolitan and eastern regions. The construction of industrial and service facilities experienced a downturn, however.

There was only a slight rise in public investment. Public works projects moved ahead more slowly than planned, partly due to the changes that had been made in disbursement procedures at the end of 1993 and partly because 1994 was an election year and a new administration took office. Significant delays in bridge and road construction were experienced during the year. Among the main public bodies, the Executive Commission for the Lempa River Hydroelectric Project (CEL) and the National Telecommunications Administration (ANTEL) recorded normal investment levels, but this was not true of the National Water and Sewerage Administration (ANDA). The public sector invested more heavily in machinery and equipment than in construction owing, in particular, to its acquisition of telephone and transport equipment and the effort being made to overhaul the electrical power sector.

The formation of the National Civil Police helped to boost public consumption, whose 3% expansion outstripped the growth rate recorded for the preceding year. The rate of increase in private consumption faltered slightly, dropping from 7% to 6%, but remained higher than GDP growth.

With a rise of nearly 14%, imports were the most vigorous component of total supply. Among domestic sectors of activity, the strongest performances were seen in areas oriented primarily towards the national market, such as construction (where output was up 10%), commerce (8.5%) and basic services (8%). The overall growth rate for the goods-producing sectors of the economy, which account for nearly half of GDP, was considerably lower than the aggregate figure owing to the downturn in agricultural output.

Trends in the coffee and basic grain crops, which together account for nearly 45% of total agricultural output, caused activity in this sector to contract by nearly 3%. More generally, the debts accumulated by agricultural producers were probably also a factor, while the drought that hit the region in late July re suited in losses in basic grains crops estimated at 20%. Coffee output was down in the western region (the main production zone), and the country was therefore unable to reap the full benefits ol the increase in international coffee prices seen midway through the year. The sugar-cane harvest v ras also slightly smaller. Output in the livestock subsector rose by 3%, while fishing and poultry farming experienced a strong expansion -above 10%- despite the fact that prospects in the Central American market did not materii lize.

Manufacturing maintained a robust growth rate of nearly 8% which was chiefly attributable to a greater utilization of installed capacity. Machinery and metal product» and wooden articles were among the most active branches of industry in 1994. The textile, clothing, paper, and beverages and tobacco industries were hurt by restrictive trade measures and by problems in carrying forward their retooling process. The *maquila* industry (i.e., inbond assembly activities) continued to display a great deal of momentum.

The output of electric power and drinking water services rose considerably (7%), although at a slower rate than the year before. During 1994, hydroelectric power gîneration was affected by the drought, and the si ipply of thermal energy -whose direct production costs are higher- was increased accordingly.

The growth of the communications and transport sector (8%) was chiefly a result of the expansion of local telephon; services. In December, the rates for international calls were cut in order to make them more campetitive with collect call services. In the transport sector, an increase was seen in the movemei it of cargo, both by sea and by air. Trends in commerce were influenced by the larger supply of merchandise, especially imported goods. A number of branch offices and new shopping centres were opened for business as well.

b) **Prices, wages and employment**

The ascent of the Consumer I'rice Index (CPi) slowed to an annual rate of just under 9% in

December. In the first quarter the cumulative increase in the CPI was over 3%; a 1.4% jump in August was triggered by expectations that the prices of staples would rise in the wake of the damage caused by the drought. Nevertheless, price movements slowed in the latter part of the year and, as a result, the overall increase for 1994 stayed within the targeted range (between 8% and 10%).

Food prices were higher than average. Seasonal variations in the supply of fruit and vegetables and shortages of maize and eggs pushed food prices up sharply in August. Housing recorded its major rises in June, when electricity rates went up, and in December, when rents were raised. In 1994 the pricing system for hydrocarbon products was changed in order to align the rates with international price levels; in a similar vein, towards the end of the year the rate structure for water consumption was modified and water charges were increased. International telephone charges were reduced, however.

Wages were adjusted at the start of the third quarter. Civil servants received a 10% pay raise in July. The adjustment of minimum wages led to increases of nearly 13% in the manufacturing, trade and service sectors and of around 12.5% for agricultural workers, with different pay rates being received for harvesting activities. Wage differences based on workers' gender, age or disability were also eliminated.

When measured in terms of consumer prices, agricultural workers' real wages improved by an average of 1.5% during the year, while industrial, service and trade workers' real wages rose by 2%. The pay rates for day labourers working in the sugar-cane and cotton harvests climbed somewhat, but the real incomes of coffee pickers lagged behind.

Reforms to the labour code agreed upon in the Forum for Economic and Social Consultation, which was established under the terms of the Peace Agreement, entered into effect in April. Measures agreed upon in the Forum included provisions calling for the creation of a Higher Labour Council, a tripartite consultative body which was due to begin work in March 1995, and the ratification of several International Labour Organisation (ILO) agreements.

At around 9%, the unemployment rate was similar to the preceding year's level. According to fourth-quarter estimates, the ns.tion-wide rate amounted to 9.4% while the raU among those members of the EAP other than pirsons seeking work for the first time was 6%. ITie number of workers covered by social security rose by 12.5%, however. Towards the erd of the year, unemployment in rural areas was comparatively low -around 4%- as growers bejjan to harvest their crops (mainly coffee and sugar cane).

c) The external sector

The trade deficit in goods anc real services rose again in 1994 (to overUS$ 1.2 billion). Even so, thanks to the trends in factoi services and private transfers, the current account deficit remained in the range of US$ 300 million. Capital inflows were more than sufficient to cover this gap, and international reserves therefore grew by some US$ 140 million.

The value of merchandise îxports rose substantially (12%), although at «i slower pace than the year before. The 1994 inc ease was due to an upsurge in export prices (over 20%) which easily offset the nearly 8% declire in physical volume. By contrast, the growth in imports, c.i.f. (18%), was primarily attributable to a quantitative increase. Thus, the physical balance of El Salvador's merchandise trade deteriorated markedly.

In 1994 El Salvador's trade deficit within the Central American subregion grew substantially. Its customary deficit with Guatemala and Costa Rica worsened in net terms, while it 5 surplus with neighbouring countries (chiefly Honduras and Nicaragua) shrank.

The value of non-traditional exports, which made up three fifths of the total, rose 14%. In contrast to what occurred in 1993, m)n-traditional exports to Central America grew less than sales of such products to the rest of the w< irld did (10% versus 13%). In terms of value, :he strongest increases in sales to Central American countries were in shoes, processed food products and detergents; outside the subregion, the greatest growth was observed in kitchen, tibie and bed linens. Sales of the two largest product lines of recent years -medicines and paper a rid cardboard packaging- slackened owing to the contraction of external demand.

Traditional exports (the foremost being coffee) rose by a little over 8% in value, compared with 36% in 1993. Decreases in sugar and shrimp sales, together with the 30% drop in the volume of coffee exports, were contributing factors. Nevertheless, thanks to a substantial rise in international coffee prices, the value of coffee sales went up by 15%. The largest coffee shipments (550,000 quintals) took place in July, when prices were starting to pick up, whereas in October, when prices peaked, only 60,000 quintals were exported. Then, when the price tumbled from US$ 214 per quintal in September to US$ 144 in mid-November, the main producing countries called an emergency meeting. The Central American nations, Colombia and Brazil agreed upon a coordinated coffee marketing plan based on quarterly programming of exports from 1995 on, the establishment of a reference price of between US$ 180 and US$ 200 per quintal, and continuation of the practice of holding back one fifth of the exportable supply.

Imports of goods, c.i.f., climbed at a faster rate than in 1993, although they failed to match the pace set in 1992. The largest increase was in capital goods (18%), followed by intermediate and consumer goods. The value of oil imports fell in 1994 owing to lower prices, while the demand for fertilizers and construction materials expanded. As regards consumer products, imports of durables rose more than non-durables, even though the latter reached a value of US$ 500 million.

The figure for net revenues from real services includes the aggregate value of *maquila* activities, which amounted to US$ 130 million. In absolute values, *maquila* exports totalled US$ 430 million (US$ 140 million more than in 1993), while imports of parts and components came to some US$ 300 million (US$ 200 million in 1993).

Unrequited private transfers amounted to US$ 1 billion, which was more than the value of merchandise exports. Thus, remittances financed the bulk of the trade deficit for goods and services. Since the remainder wa i easily covered by capital movements, by the end of the year the Central Bank's reserves had increased to the equivalent of nearly four months' worth of imports.

Official grants and donations totalled US$ 280 million, which was somewhat less than the current-account deficit. On the other hand, an increase was seen in long-term external lending, particularly to the public sector. Amortization payments also incr;ased, however, especially on the part of commercial banks, and the net amount of long-term financing therefore fell to around US$ 40 million (US$ 100 million in 1993). Accurate figures on private capital movements were unavailable, but it is likely that inflows were stimulated by interest rate spreads and the country *s lower level of f jreign exchange risk.

The Government entered into a number of credit arrangements with multilateral organizations during the year, obtaining US$ 118 million from the Inter-American Development Bank (IDB), US$ 71 million lirom the World Bank and US$ 97 million from the Central American Bank for Economic Integration (CABEì). Loan agreements for smaller sums were also signed with bilateral organizations and financial institutions. El Salvador was able to honour its amortization commitments and the Central Reserve Bank madiî prepayments amounting to nearly US$ 150 million. Even including exchange losses of around US$ 25 million on deposits denominated in yen and deutsche mark, the external public debt rose very little (by US$ 67 million). This, the country's debt ratios improved, with an interest load equivalent to just over 7% of txports and debt servicing equivalent to 28% of lixports.

As a result of the debt forgiveness agreements which the Government of El Salvador signed with the Governments of the United States and Canada in September 1994, the operating budget for the El Salvador Environmental Fund (FONAES) was approved in order to provide financing for environmental protection, reforestation, pollution control and water treatment projects.

GUATEMALA

1. General trends

In 1994 the Guatemalan economy once again recorded growth of around 4%, while inflation was kept to the moderate rate of about 12%. These results were achieved despite the tense political situation created by the existing stand-off among the different branches of Government and the slow pace of talks aimed at putting an end to the armed conflict being waged in the country. Bolstered by higher prices for Guatemala's leading exports (especially coffee and sugar), the country's terms of trade also showed a significant improvement in 1994. Moreover, the implementation of the Government's monetary and fiscal policies went smoothly until late in the year, despite the tensions besetting both. Thanks to this combination of circumstances, no appreciable pressure was brought to bear on the foreign-exchange market, and the price of the dollar actually dropped slightly.

Potential imbalances loomed, however. In spite of favourable trends in external prices, the country's huge deficit on the current account of the balance of payments, which vas financed entirely out of capital inflows, wai; not reduced to any significant extent, as it still e quailed about 5.5% of GDP (as compared to 6% in 1993). In addition, the state of public finance > deteriorated due to the mediocre results achieve d in terms of tax collection. Tax receipts fell to less than 7% of GDP (the figure for 1993 had bee 17.5%); both a decrease in income tax receips and, more generally, the continuation of aiministrative practices which provide little incentive for tax compliance contributed to this stuation. The public sector's demand for financing exerted heavy pressure on the managemenl of monetary policy in the latter part of 1994, and this was reflected in a substantial increase n the money supply.

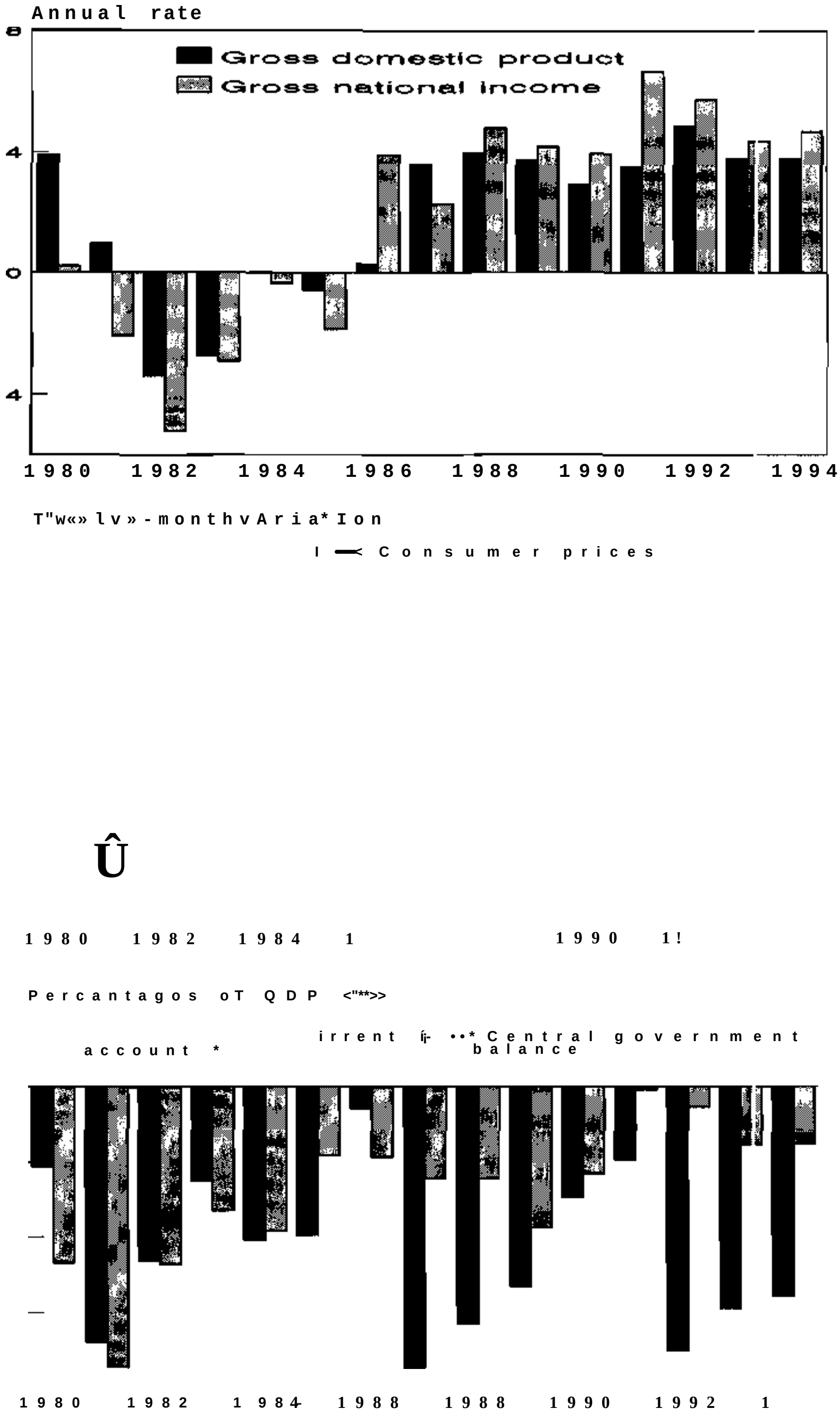
2. Economic policy

In 1994 economic policy was shaped by the shadow agreement reached with the International Monetary Fund (IMF) during 1993 as a prelude to the conclusion of a stand-by agreement. The stand-by agreement did not, however, materialize, due to the Government's failure to meet a number of targets, particularly in the areas of public finances and electricity rates. As a result, the country even had difficulty in renewing the shadow agreement.

Some of the more noteworthy features of the original agreement reached with the IMF included the deregulation of fuel prices and the liberalization of the foreign-exchange market, the adjustment of electricity rates, a renegotiation of the country's debt with the Paris Club, and tax reforms designed to raise tax revenues to the equivalent of 8.5% of GDP and eisure a total public-sector deficit of a scant 0,5% of GDP. Other targets included the avoidance of any variation in net international reserves, a cut of 443 million quetzals in net credit I o the central government, and a reduction in the Bank of Guatemala's quasi-fiscal losses.

Monetary targets were largely met, since the net international reserves held by the Bank of Guatemala rose by approximately US$ 60 million and net credit to the central government was down by almost 500 million quetzals. On the other hand, quasi-fiscal losses exceeded the established target by the equivalen of around 0.2% of GDP, while the public-s actor deficit

Figure 1
GUATEMALA: MAIN ECONOMIC INDICATORS



8ourco: ECLAC, on the basis of official figures.
» CDT the balance of oaymente*.

overshot the original target by the equivalent of almost 2% of GDP. During 1994 the authorities also deregulated fuel prices and relaxed controls on the foreign-exchange market, as well as regularizing Guatemala's debt with countries belonging to the Paris Club. Electricity rates were not adjusted, however, because the constitutionality of the planned adjustment was being challenged in the courts.

The stand-off between Congress and the Executive blocked the passage of legislation aimed at strengthening the tax collection system. This situation precipitated a drop in income-tax revenues, as it proved impossible to expedite the amendment of a number of discrepancies in the relevant tax law which, early in 1994, had prompted a finding that the collection of revenues under this tax category was unconstitutional. The dispute among the different branches of government was finally laid to rest by the election of a new Congress and new judicial authorities, who took office in September. Tax reform legislation was passed by Congress in late December, but there were some indications that members of the business community would challenge its constitutionality in the courts.

a) **Fiscal policy**

The central government's fiscal balance showed a deficit amounting to 1.5% of GDP. Although this was similar to the figure for 1993, in 1994 a decrease was seen in both government income and government expenditure (measured as a percentage of GDP). Indeed, the most striking feature of the situation with respect to public finances was the fall-off in tax receipts. Revenue from direct taxes plunged by more than 25% in nominal terms, while the increase in receipts from indirect forms of taxation was not large enough to keep pace with inflation.

It would appear that the shortfall in tax revenues can be traced to a number of different factors, including flaws in the internal revenue service, the absence of stiff penalties for those who fail to pay their taxes, and the numerous exemptions contained in the Income Tax Act; in addition, collection of the value-added tax (VAT) was inadequately supervised. The Constitution also places a number of stumbling blocks in the path of tax legislation, since its inc usion of a set of provisions of an almost statutory nature leaves the door wide open for legal challei iges to the tax laws.

Against this background, 1994 saw a sharp decline in public expenditure, as the 1.5% nominal increase in this spending level was far below the rate of inflation. A particularly notable reduction was observed in real investment by the central government, and this adversely affected the condition of motorway ind energy infrastructure, as well as the leve! of attention provided in such areas as health, ed ¿cation, legal services and public safety. By wa) of example, the Government's decision to suspe id its transfer payments to the National Electrification Institute had a direct impact on the maintenance and state of repair of electrical power generators. Motorways were also affected, since only some 15 million quetzals were spent on highway projects rather than the 65 million quetzals that had originally been budgeted. By thi ; same token, the Government was forced to delay its transfer payments to the Judiciary, and this meant that funding was not available for the im] Cementation of the new Procedural Penal Code, which was one of the mechanisms to be used I o modernize the justice system. Difficulties were also encountered in recruiting schoolteachers, running hospitals, and paying at d outfitting members of the police force.

The precarious financial position of the Government, which had made a commitment to reduce its debt with the Bank of Guatemala, prompted it to launch a public offeri ig involving a total of 850 million quetzals in securities. In so doing, it used up the whole of its Congressionally-authorized quoi a for bond issues for fiscal years 1987 through 1993, and in 1994 it was therefore necessary for Congress to renew its authorization in order for the Government to issue any more paper. The resources generated by this means were used to reduce the Government's debt with the Bank of Guatemala by about 500 million quetzals and to finance current expenditures, particularly the public-sector payroll.

Fiscal problems hampered the implementation of monetary policy. The

Table 1

GUATEMALA: MAIN ECONOMIC INDICATORS

	1987	1988	1989	1990	1991	1992	1993	1994'
				Growth rates				
Growth and investment								
Gross domestic product	3.6	4.0	3.7	2.9	3.5	4.9	3.8	3.8
Per capita gross domestic product	0.7	1.0	0.8	-	0.6	1.9	0.8	0.9
Gross national income	2.3	4.8	4.2	4.0	6.7	5.7	4.4	4.7
Gross domestic product by sector								
Goods	3.8	4.4	3.1	2.6	2.8	4.7	2.1	2.0
Basic services	5.6	5.5	9.7	6.1	5.4	9.1	6.4	6.7
Other services	3.1	3.4	3.6	2.9	4.0	4.4	5.1	5.1
				Percentages				
Contribution to growth of GDP [c]								
Consumption	5.1	4.0	3.4	1.7	3.0	7.3	5.0	4.7
Government	0.6	0.5	0.4	0.3	0.2	0.5	0.7	0.4
Private	4.5	3.5	3.0	1.4	2.8	6.7	4.2	4.3
Gross domestic investment	3.8	-0.2	0.1	-0.2	3.0	4.6	-1.1	0.1
Exports	1.6	0.9	2.2	1.2	•1.0	1.4	1.3	0.8
Imports	6.8	-0.8	-1.9	0.2	•1.4	-8.4	-1.3	-1.9
				Percentages of GDP [b]				
Gross domestic investment	14.8	14.1	13.6	13.1	15.5	19.1	17.3	16.8
National saving	**7.8**	8.1	**8.5**	10.3	13.5	11.5	10.6	10.3
External saving	**7.0**	6.0	**5.1**	**2.7**	2.0	7.6	6.7	6.5
				Percentages				
Employment and wages								
Activity rate	53.4	52.5	52.3	52.1	52.1	52.1	52.1	52.1
Open unemployment rate [e]	11.4	8.8	6.1	6.5	6.4	5.7	5.5	5.2
Real minimum wage (Index: 1990=100)	126.8	157.5	141.3	100.0	80.7	72.5	62.8	
				Growth rates				
Prices (December to December)								
Consumer prices (nation-wide)	10.1	11.0	20.2	59.8	10.0	14.2	11.6	11.6
External sector								
Terms of trade (Index: 1990=100)	92.5	93.7	94.9	100.0	107.9	111.1	111.5	115.9
Nominal bank exchange rate (quetzales per dollar)	2.5	2.6	2.8	4.5	5.0	5.2	5.6	5.7
Real effective exchange rate (Index: 1990=100)	84.1	85.0	85.4	100.0	87.9	87.0	88.2	84.6
				Millions of dollars				
Balance of payments								
Current account	-535	-497	-438	-235	-186	-758	-689	-724
Trade balance (goods and services)	-456	-462	-437	-244	-342	-955	-941	-1011
Exports	1 136	1269	1424	1568	1687	1898	2 018	2 306
Imports	1593	1731	1 861	1812	2 029	2 853	2 960	3 318
Capital account	482	355	510	205	740	738	833	722
International reserves (variation)	-62	-140	84	-35	554	-19	144	-1
				Percentages				
External debt								
Public debt (as a percentage of GDP)	34.4	29.7	29.9	30.1	23.6	20.8	17.8	16.4
Net interest (as a percentage of exports)	10.9	11.7	10.4	10.7	5.7	7.5	4.9	4.6

Table 1 (conclusion)

	1987	1988	1989	1990	1991	1992	1993	1994[a]
	Percentages of GDP							
Central Government								
Current income	9.4	10.1	9.4	7.9	9.0	10.1	9.0	7.6
Current expenditure	9.5	10.1	10.1	8.5	7.6	7.8	7.5	6.9
Saving	-0.1		-0.6	-0.6	1.5	2.4	1.5	0.8
Capital expenditure	2.3	2.4	3.1	1.7	1.5	2.9	3.1	2.3
Financial balance	-2.4	-2.4	-3.8	-2.3	-0.1	-0.5	-1.5	-1.5
	Growth rates (percentages)							
Currency and credit								
Monetary balance of banking system								
Domestic credit	14.2	11.9	9.8	20.5	15.1	11.2	5.8	34.4
To the public sector	-21.8	-11.7	23.5	-1.1	94.7	-31.0	-34.4	18.3
To the private sector	24.4	15.0	9.6	16.6	18.4	35.1	15.3	22.9
Money (Ml)	11.8	14.3	20.7	33.9	18.3	5.4	21.1	39.9
Savings and time deposits (in local currency)	17.4	9.2	14.8	13.7	64.1	27.4	3.4	8.3
M2	15.3	11.1	17.1	21.7	44.1	19.5	9.0	19.4
	Annual rates (percentages)							
Real interest rates (annualized)								
On deposits			-5.2	-23.9	13.1	-3.4	1.0	-1.7
On loans		2.7	-2.7	-20.6	22.0	4.6	11.8	10.2
Equivalent interest rate in foreign currency [g]		4.3	-5.4	-1.7	22.7	6.2	1.9	12.8

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. Based on 1980 dollars at constant prices. [c] These entries measure the impact c f the variation in each aggregate on the variation in ODP. The coefficients were obtained by multiplying each aggregate's annual growth rate by the level of that aggregate as a percentage of GDP. Percentages of the working-age population. [e] P srcentages of the economically active population. Refers to net interest as shown on the balance of payments, divided by exports of goods and services. [8] Nominal interest rate on deposits, deflated by the variation in the exchange rate.

Table 2

GUATEMALA: MAIN QUARTERLY INDICATORS

	1992				1993				1)94[a]			
	I	II	III	IV	I	II	III	IV	I	II	III	IV
Consumer prices (12-month variation, *%)*	10.1	8.9	11.2	14.2	12.0	14.4	13.4	11.6	14.2	11.8	12.0	11.6
Real effective exchange rate (Index: 1990=100)	88.6	85.6	87.5	86.4	85.8	86.7	90.0	90.2	87.3	84.9	83.9	82.1
Real interest rate (annualized)												
On deposits (%)	-2.0	-0.4	-3.1	-7.9	5.6	-5.2	3.5	-	-2.2	1.5	-1.8	-4.3
On loans (%)	5.7	7.7	4.7	0.1	16.3	4.9	15.0	11.1	8.5	13.4	11.5	7.5

Source: ECLAC, on the basis of figures from the Bank of Guatemala.
[a] Preliminary figures.

measures adopted early in the year called for a reduction in open-market operations and a lowering of legal reserve requirements in order to pave the way for a drop in interest rates. These steps were to be coupled with compensatory policies to enable the Government to retire more of its debt with the Bank of Guatemala than originally planned and to increase public-sector deposits with the Bank. The debt retirement target was attained, while public-sector deposits, especially those made by the central government, exhibited a positive trend up until the last quarter of 1994, increasing from 1.182 billion quetzals in January to 2 billion quetzals in September. From October on, however, the level of these deposits began to decrease, and by the end of 1994 they had dropped to 1.276 billion quetzals.

b) **Monetary policy**

Over the course of 1994, the monetary base grew by 16%, which was higher than the rate of variation in domestic prices. Domestic loan operations conducted by the Bank of Guatemala were the main source of primary money creation. Further factors contributing to this expansion were the increase in the Bank of Guatemala's net international reserves -which was attributable in part to sharply higher export prices- and the disbursement in December of a US$ 35 million loan by the Inter-American Development Bank (IDB).

The money supply jumped by 40% in 1994, after having expanded by 21% the year before. Despite the fact that interest-bearing deposits continued to mount at a relatively slow rate (8% in 1994), local-currency liquidity (M2) also rose in real terms. The increase made by the banking system in the supply of domestic credit outstripped the inflation rate, with loans to both the public and private sectors growing by around 20%.

Throughout the year the monetary authorities implemented a policy designed to bring down interest rates; under this policy, the legal reserve requirement was lowered, first from 21% in January to 20% in June and then from 20% to 14% between July and December. As a complementary measure, open-market operations were suspended starting in August. The authorities partially offset these liquidity-boosting measures by r using the level of mandatory investments whicli banks had to make with the Bank of Guatemala from 15% to 19.5% between January and September. The initial expectation had been that tie relaxation of monetary policy could be ba anced out by increasing public-sector deposits with the Bank of Guatemala by a greater amount than originally planned. However, as noted earlier, the trends in these deposits did not follow the e spected course.

Overall, interest rates on financial transactions moved downwsrd. Thus, on average, nominal bank lending Rites fell to 20% for the year -compared with 25% in 1993- while the drop in the yields of securities issued for purposes of monetary control was even more dramatic. In view of the lack of volatility displayed by both the inflation and exchange rates, a majority (around 70%) of the securities floated on the open market had tei ms of over nine months, as had also been the case in 1993.

c) **Foreign exchange policy**

Measures were implemented during the year that altered the way in which the foreign exchange market operated and made the system more flexible. In March 1994, a series of decisions issued by the Monetary Board stipulated that all sales and purchases of foreign exchange would thereafter be conducted in the banking market at a rate of exchange freely agreed upon by the parties involved. This put an end to the pre-existing system, which had been based on daily auctions conducted by the Bank of Guatemala using a base rate determined in the preceding auctions. Under the njw scheme, the Bank of Guatemala was authorised to step into the market in order to avert shaip swings in the exchange rate. The Bank ol Guatemala's intervention in the market during 1994 entailed US$ 85 million in currency sales and US$ 130 million in purchases. These transactions partially offset the currency's tendency I o appreciate in value as a result of the comparative lack of uncertainty as to the market's course in the immediate future, given the higher prices being brought by Guatemala's leading export products on the international market.

3. The m; variables

a) Economie activity

Gross domestic product (GDP) increased by 4%, which was 1% above the population growth rate. Accordingly, per capita GDP rose, although at a slow pace, for the eighth year in a row; even so, this coefficient was still lower than it had been at the start of the 1980s. The improvement in the country's terms of trade, together with a smaller volume of net payments to external factors, caused national income to climb by about 5% in 1994, which was higher than the growth rate for GDP.

Domestic spending and export volumes rose by similar amounts (more than 4%). Exports drew their momentum from the strong growth recorded in non-traditional items, since sales of traditional products were sluggish. The volume of imports of goods and services once again expanded faster than domestic activity, and the country's merchandise trade deficit widened as a result.

Consumption expanded by nearly 5%, reflecting increases in both government and private-sector expenditure. Private consumption, which rose by the equivalent of more than 4% of GDP, was influenced by higher real wages, remittances from abroad and the greater availability of credit. The fact that consumption rose faster than output signified a continuation of the downward trend seen since 1991 in nominal saving's contribution to the financing of investment; in 1994 that contribution came to slightly more than 10% of GDP. The flow of external saving, for its part, remained at around 6.5% of GDP. The higher level of economic activity notwithstanding, fixed investment slackened, and the coefficient for fixed capital formation therefore fell to around 13.5% of GDP.

The growth of GDP was spread out among all the major areas of production activity with the sole exception of construction, where, for the second year in a row, output was lower than it had been the year before. One explanation for this decline may be the saturation of demand for high-income housing and upscale shopping centres. In contrast, construction of hotel complexes and of housing for middle-income groups was more buoyant, althoi gh the growth rate for these activities was still enly moderate.

The output of services once a;;ain expanded faster than the production of goods. Basic services displayed a notable degre< of dynamism, expanding by around 7%. Growth ivas especially marked in telephone services, but the increase in the output of electricity, gas and water services was also significant. Under the "ether services" heading, upturns were observed in financial activities (6%) and commerce (;>%). The 2% growth rate recorded for the production of goods was rather slow and represented a slight downturn from 1993. The continied lackluster performance of agriculture, slack activity in manufacturing and the slow-down in construction were all factors in thi.t outcome.

The agricultural sector recorded only modest growth (2%) despite greater liquidity and improved prices for its leading exiort products. This may be partially attributable to the steep decrease in crops intended for domestic consumption, which were hard-hit by a severe drought, and the slow pace of growth seen in the production of coffee and sugar cane. Farming activities also felt the effects or land tenure disputes which prompted takeovers of some rural properties; in addition, a number of crops were damaged by pests and diseases.

The coffee harvest, which is the country's largest crop, expanded by a scant L%. This was largely due to the delayed effect (if a sustained period of low international prices, during which there was less of an incentive to maintain coffee plantations in good condition. This situation was aggravated by the producer countries' agreement to withhold exportable surpluses fix m the market in an effort to drive up international coffee prices. The amount of land devoted to sugir-cane crops increased, but sugar production ros ; by only 3%. Consequently, export volumes of sugar grew by a mere 1%, the lowest rate in recent years. One highlight on the export front was th< ; 7% increase in banana production, which was reflected in a significant rise in the volume of bi nana exports (11%). Rebounding international prices and the buoyancy of the United States market played a major role in this achievement, since these factors far outweighed the effects of the barriers erected by the European Union against imports of bananas from Latin America.

Cardamom production climbed by almost 16% in response to highly advantageous international prices. Even so, export volumes were far below the very high levels characteristic of the 1980s. It is likely that cardamom was exported through triangular trade arrangements with other countries. Cotton production fell yet again (-32%) despite better international prices. Non-traditional export products -particularly some fruits and vegetables- turned in a reasonably robust performance.

The output of basic grains plunged as a result of the acute drought that devastated grain-producing areas; maize production was sharply lower (-15%), and an even more dramatic fall was seen in the case of rice (-21%). Bean production also showed a steep drop (-11%), as the impact of the drought was compounded by a viral disease which is transmitted by the whitefly.

The upward trend exhibited by livestock and farming activities in recent years continued apace. The size of pig and cattle herds increased, as did the number of animals slaughtered. Much the same situation was observed in the poultry industry. The output of milk, eggs and honey also climbed.

Manufacturing maintained a modest rate of growth (3%) despite the significant increase in exports to Central America and improved earnings from sales to the United States by *maquila* operations producing textiles and clothing. Given the solid performance of manufacturing exports, it must be assumed that the overall sluggishness of the manufacturing sector was due to a weak showing on the part of industries which cater to the domestic market. The economy's top performers include the food, glass and chemicals industries.

One new development in 1994 was a closer monitoring of industry's impact on the environment. Three textile firms were temporarily shut down, while others became the target of complaints from environmental watchdog agencies. This prompted a number of companies to decide to install water treatment facilities for their plants.

b) Prices, wages and employment

Inflation was under 12%. This was higher than the 8% target set at the start of the year, but was quite close to the rate recorded in 1993.

An examination of the variations between annual averages reveals widely d iffering rates of price increases. The steepest uoswing was in education (36%), but food and beverages -both of which figure prominently in the shopping baskets of low- and middle-incone groups- also registered above-average price hikes (16%). The other categories (clothing, medical care, and transport and communications) had below-average price increases of between 4% and 8%.

Real wages recovered slightly, but remained below the wage levels of the eirly 1980s. The aggregate level of employment showed almost no variation, with employment rising in manufacturing and commerce but apparently declining in such sectors as agriculture, mining, construction and other services. Although the open unemployment rate fell somewhat (to 5.2%), underemployment contirued to be very widespread. Consequently, (he equivalent unemployment rate (which takes both indicators into account) was still above 37% of the economically active population <EAP).

c) **The external sector**

Despite the sizeable increase in merchandise exports, the country's trade in goads and services again showed a very large de ficit: more than US$ 1 billion, or nearly 8% of GDP. This was partially offset by the continued rise in private transfer payments, which include remittances sent by Guatemalans residing overseas (amounting to about 2.5% of GDJ). Nevertheless, the current account deficit toppsd the US$ 700 million mark, which was equivalent to over 5% of GDP. Capital inflows were down from the high levels recorded in 1993, with the drop in flows of short-term funds being especially marked. Inflows made up of loans to commercial banks and import-related commercial credits constituted particularly noteworthy components of the country's capital movements. Despite the downturn, however, these inflo ÏVS did prove to be large enough to cover the current account deficit.

The value of merchandise exports rose by 12%, the highest growth rate to be recorded in the last five years. Sales to Central America and to the rest of the world exhibited similar growth rates. Prices of the leading traditional exports -including coffee, sugar and cardamom- climbed steeply, while banana prices rose at a more moderate pace. Non-traditional exports, for their part, showed a significant increase (on the order of 10%).

Imports of goods, c.i.f., expanded by 7% to almost US$ 2.8 billion. Higher purchases of consumer goods (up 21%) were the main factor contributing to the increase. In contrast, imports of capital goods decreased slightly. Imports of intermediate goods rose moderately (4%) as the net result of a small drop in petroleum and fuels and a small rise in building materials.

With respect to trade in real services, tourism showed a deficit for the first time in six years; this turnaround was attributable to a rapid increase in costs and the drop in income caused by the cancellation of trips in reaction to the area's political instability. Income received in the form of private transfer payments totalled about US$ 400 million, which was more than the country's export earnings from coffee.

The most important event in connection with the external debt was the successful conclusion of negotiations with most of the countries belonging to the Paris Club. These negotiations allowed Guatemala to regularize its payments situation with Canada, France, Germany and Italy. Although it was unable to regularize its bilateral debt with Spain, Guatemala did make substantial inroads by setting up a negotiation process and reducing its debt witi that country from US$ 480 million to US$ 180 million. On the other hand, Guatemala's failure to meet targets agreed to in its understandir g with the IMF prompted that organization to cut off funding; this situation may eventually have an adverse effect on Guatemala's access to other multilateral sources of credit.

The public sector's net extenal debt rose slightly, from US$2.086 billior in 1993 to US$ 2.108 billion in 1994. The Bank of Guatemala's debt decreased by US$ 140 million in the course of 1994, but the non-financial public sector's climbed by US$ 162 million over the same psriod. Part of the reason for the increase in the latter's debt was the appreciation of currencies included in the basket of currencies in which some obligations with international financial organizations are expressed.

HAITI

1. General trends

The recession which overtook Haiti after its institutional breakdown in 1991 continued to worsen in 1994 as a consequence of the sanctions imposed by the international community, since it was not until late in the year that efforts to find a solution to the crisis met with success.

Thus, the gross domestic product (GDP), which had dropped by nearly 20% in the preceding three years, fell by more than 12% in real terms, bringing per capita GDP to US$ 260, the lowest in the region.

After the initial failure of the negotiations coordinated by the United Nations, the trade embargo was tightened in May, causing severe damage to the economy. The transport and energy sectors were especially hard hit because of the resulting oil shortage, and the already shaky condition of the real economy was thus exacerbated. It was not until October, when civilian government was restored, that the embargo was lifted.

Exports and imports contracted. In the course of the year, the local currency (the gourde) was devalued by an average of 20% in nominal terms, domestic prices jumped by 52% during the 12 months leading up to September 1994, and unemployment topped 60%. These indicators account for the country's high rate of clandestine emigration. In addition, a severe deterioration of government operations was seen as fiscal revenues plummeted. Moreover, all this occurred in the midst of a serious institutional crisis which had a particularly strong impact on the banking system.

This was how the situation stood at the close of fiscal 1994, when the reinstatement of a civilian president made it possible to lift the embargo and normalize the country's trade and financial relations with the rest of ti le world. The authorities instituted reforms providing for the elimination of the constraints which were hampering the recovery of production, discouraging investment and limiting the country's ability to absorb the anticipated flow of foreign aid.

Nevertheless, the prospects :br an early resumption of growth remained incertain. By 1994, in the aftermath of a three-year political crisis and the more recent imposition of international sanctions, the production base of Haiti's economy had gone into a tîilspin. With the virtual disappearance of the country's subcontracting industry, the manufacturing sector lost its most dynamic corrponent. The shortage of petroleum products led people to plunder forested areas in order to obtain fuel and to supply the market for charcoal, t lereby doing serious damage to the agricultural ecosystem. Furthermore, topsoil washed down by the rains turned into mud that dirtied coasti 1 waters and suffocated the coral reefs and fish farms, all of which hurt fishing and tourism and made the resumption of sustainable growth even more problematic.

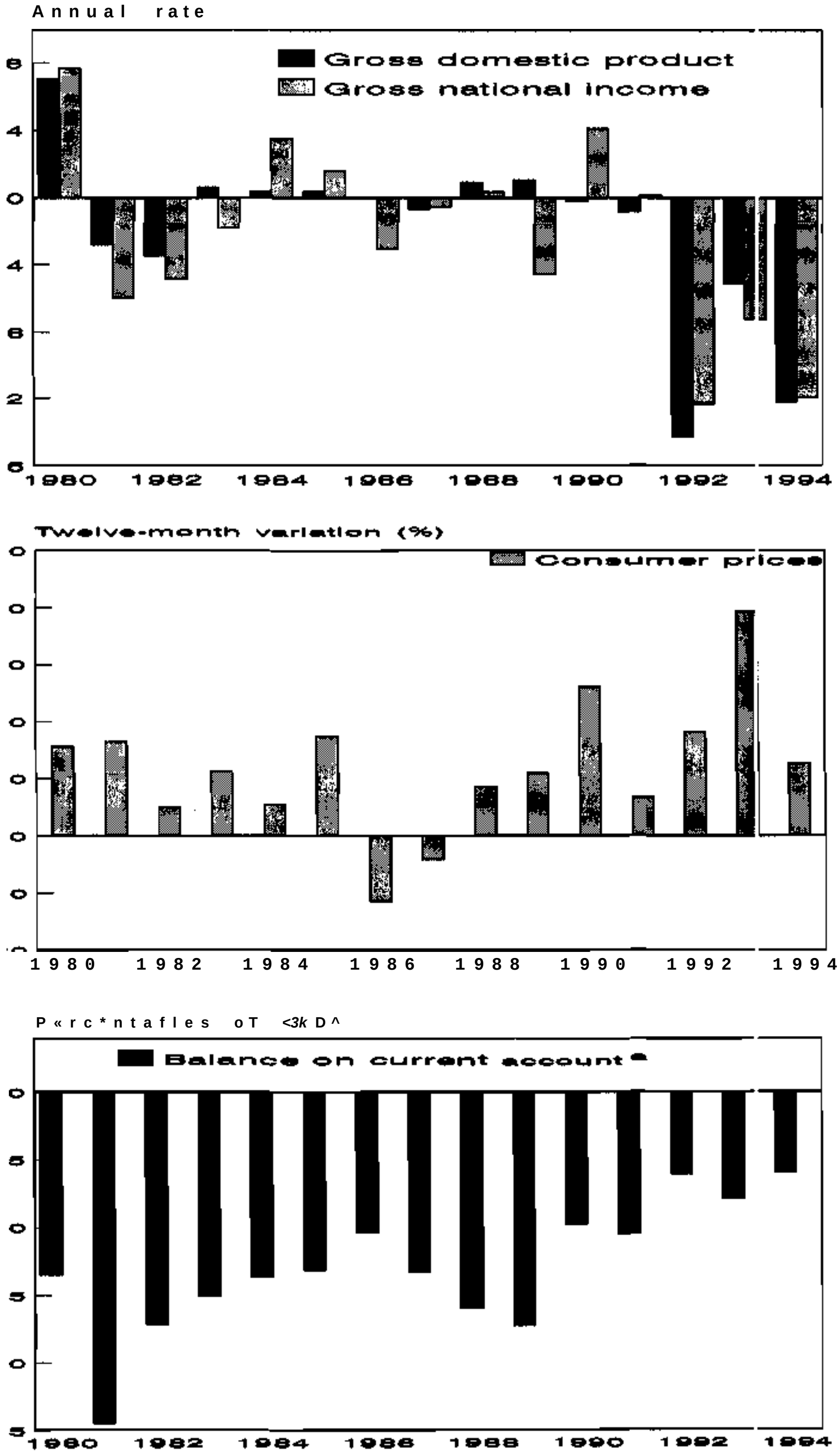
2. Economic policy

In 1991, the first democratically elected Government in Haiti's history had sought to establish a healthy macroeconomic environment and to cultivate the credibility it nee led to obtain

The years referred to in this report are fiscal years, which run from 1 October to the following 30 Septemb :r.

Figure 1

HAITI: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.
ª Of the balance of payments.

more international assistance by undertaking reforms in the areas of finance, the civil service, exchange-rate and trade regimes, and pricing policy. In particular, the Government took steps to bring the country's fiscal accounts under control by raising taxes and cutting expenditure, especially by trimming surplus staff from the government payroll. Late in September 1991, however, after this administration had been in office for only eight months, the entire picture changed when a military coup brought down the Government and installed a *defacto* regime from which the international community withheld recognition.

The country's economic policy in 1994 was in large part shaped by the severe deterioration of the public sector's finances in 1992 and 1993 as a consequence of the slump in economic activity and inefficient fiscal management. The persistence of a large budget deficit in 1994 forced the Bank of the Republic to increase its currency issues and, given the suspension of external financing (the chief source of funds in previous years), to accumulate arrears in its servicing of foreign and domestic debt.

With a civilian president once more in office and the political situation beginning to return to normal, in October 1994 the first steps were taken to bring the country's fiscal situation under control, downsize the public sector, liberalize the foreign trade regime and do away with the restrictions that were hampering private investment.

a) Fiscal policy

During 1994 a serious deterioration was seen in Haiti's public finances as the result of a sharp drop in current income (-26%). This decrease was, in turn, caused by the general downturn in economic activity, the effects of international sanctions and the worsening performance of public enterprises. Another highly significant factor was the country's increasing ungovernability, which took the form of rampant tax evasion and a lack of accountability with regard to expenditure. As a result, the tax performance ratio fell to a mere 3.4% of GDP.

Meanwhile, current expenditure rose by 12%, mainly because of a 40% jump in extrabudgetary outlays. Expenditure on civil seivants' wages was up by 6% in nominal tenas; this item accounted for over half of all pubic expenditure and far exceeded total income. Capital expenditure was once again negligible.

Accordingly, the central government's deficit continued along its upward path, rising from 3.8% to 5.4% of GDP. Given the evaporation of foreign finance and the absence of a domestic financial market, the expansionary pressure which the fiscal shortfall brought I o bear on the money supply mounted. As a resul t, 85% of the deficit was covered with credits from the Bank of the Republic and the remainder was financed by deferring payments on foreign and domestic debts.

As the year came to a close, th ; expectation was that the normalization of tie country's political situation would open thï way for a resumption of foreign assistance, in¡ ismuch as the country's short-term requirements, for example, were estimated to amount to over US$ 500 million.

b) Monetary policy

As already mentioned, money ɑ< ation and the resulting inflation tax were once igain used to enable the public sector to function in 1994. The credit extended to the Governmenl, which rose by 26%, thus became the chief factor in the expansion of the monetary base and liquidity. The effect of this was mitigated by t tie lower rate of increase in net credit flows tc the private sector, which had been dealt a heavy blow by the contraction in the production bise and the country's economic problems. The nominal growth in these credit flows dropped from 25% in 1993 to only 6% in 1994, which translated into a sharp reduction in real terms.

In July, Parliament approved the Bank of the Republic's proposal to suspend the legal ceiling on the issuance of currency. Over the year the money supply (Ml) swelled by 19%. This expansion was concentrated in currency outside banks, which increased by 25% -an understandable preference in view of the uncertain economic situation and the proliferation of informal activities. E ank demand deposits, by contrast, rose only 8%.

Table 1

HAITI: MAIN ECONOMIC INDICATORS

	1987	1988	1989	1990	1991	1992	1993	1994'
			Growth rates					
Growth and investment								
Gross domestic product	**-0.7**	**0.9**	1.0	**-0.2**	-0.8	-14.3	-5.1	-12.2
Per capita gross domestic product	**-2.6**	**-1.1**	**-1.0**	**-2.2**	-2.8	-16.0	-7.0	-14.0
Gross national income	**-0.6**	**0.3**	**-4.5**	**4.1**	0.1	-12.3	-7.2	-11.9
Gross domestic product by sector								
Goods	**-0.1**	**1.7**	**0.4**	**-1.2**	0.5	-9.8	-9.7	-15.8
Basic services	**10.1**	**6.8**	**3.4**	**3.0**	-8.1	-13.1	-6.7	-42.0
Other services	**-1.2**	**0.2**	**0.9**	**1.2**	-2.1	-18.9	2.4	-3.1
			Percentages					
Contribution to growth of GDP [c]								
Consumption	-0.3	2.8	-3.3	2.9	-0.6	-7.3	-4.0	-7.4
Government	0.2	-	-	-0.2	-0.2	1.1	0.2	-1.4
Private	-0.5	2.8	-3.3	3.0	-0.4	-8.5	-4.2	-6.0
Gross domestic investment	0.2	-0.9	-1.2	-1.3	1.6	-9.1	-1.1	-6.8
Exports	2.7	-3.1	1.5	-4.6	0.4	-9.7	1.8	-6.8
Imports	-3.3	2.1	4.1	2.9	-2.3	11.9	-1.8	8.9
			Percentages of GDP					
Gross domestic investment	21.7	20.6	19.2	18.0	19.8	12.5	12.0	5.9
National saving	10.9	8.4	7.3	8.2	8.9	5.2	2.3	-2.0
External saving	10.8	12.2	11.9	9.8	10.8	7.3	9.7	7.9
			Percentages					
Employment and wages								
Real minimum wage (Index: 1990=100)	129.1	129.3	120.4	100.0	84.7	71.7	60.4	44.3
			Growth rates					
Prices (September to September)								
Consumer prices	-13.8	8.3	7.3	21.8	6.8	23.8	26.9	52.1
External sector								
Terms of trade (Index: 1990=100)	115.5	109.0	84.2	100.0	95.4	84.8	72.6	69.9
Nominal exchange rate (gourdes per dollar)	5.5	5.9	6.3	7.4	7.7	9.1	12.4	14.9
Real effective exchange rate (Index: 1990=100)	88.2	93.1	96.4	100.0	94.0	95.2	112.0	101.0
			Millions of dollars					
Balance of payments								
Current account	-146	-170	-178	-152	-176	-99	-126	-93
Trade balance (goods and services)	-181	-206	-211	-180	-235	-160	-190	-127
Exports	320	275	237	244	250	126	120	75
Imports	502	481	448	424	484	286	310	202
Capital account	152	195	179	179	154	68	99	56
International reserves (variation)	14	19	3	-6	16	-12	-15	-13
			Percentages					
External debt								
Public debt (as a percentage of GDP)	68.3	73.1	78.0	53.9	48.2	50.2	55.8	60.1
Net interest (as a percentage of exports)	5.9	8.4	9.7	8.6	10.0	7.1	7.5	12.0

Table 1 (conclusion)

	1987	1988	1989	1990	1991	1992	1993	1994[a]
				Percentages of GDP				
Central government								
Current income	9.0	9.0	9.3	7.8	7.8	5.8	5.7	3.4
Current expenditure				8.8	8.2	8.4	9.2	8.5
Saving				-1.0	-0.4	-2.6	-3.5	-5.1
Capital expenditure				0.3	0.2	0.2	0.3	0.4
Financial balance				-1.3	-0.5	-2.8	-3.8	-5.4
				Growth rates				
Currency and credit								
Monetary balance of banking system								
Domestic credit	4.0	6.7	15.3	-10.9	2.9	24.7	27.9	12.9
To the central government	5.2	8.0	8.5	-16.4	7.2	16.2	16.3	25.8
To the private sector	1.7	8.4	26.2	5.6	6.0	3.8	24.5	6.3
Money (Ml)	14.7	17.7	10.5	1.2	5.1	24.8	33.3	18.5
Savings and time deposits (in local currency)	8.2	5.3	11.0	28.0	13.4	29.2	38.8	13.1
M2	11.3	11.5	10.7	14.0	9.6	27.3	36.4	15.4

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. Based on 1980 dollars at constant prices. [c] These entries measure the impact cf the variation in each aggregate on the variation in GDP. The coefficients were obtained by multiplying each aggregate's annuil growth rate by the level of that aggregate as a percentage of GDP. Refers to net interest as shown on the balance of payi tients, divided by exports of goods and services.

Increased liquidity in the formal foreign-exchange market brought pressure to bear on the local currency, whose average nominal value for the year proved to be one fifth lower than in 1993. The economy's high liquidity drove down nominal interest rates to negative levels in real terms. From March to September 1994, nominal interest rates on fixed-term deposits were between 5% and 6%, depending on the term, while interest rates on savings deposits hovered below 3%. With the credit market weakened by the country's exceptionally severe recession, interest rates on loans jumped from 13% to 23%. This exacerbated the a ready critical plight of financial intermediaries, which since the preceding year had been requirec to maintain very high minimum reserves (73% on current accounts and 46% on savings deposits).

3. The main variables

a) Economic activity

In 1994 all the components of supply and demand were down, in some cases quite sharply. As a result of the trade embargo and the existing constraints in terms of foreign financing, investment crashed (-57%) to 6% of GDP, which was less than one third of the level recorded at the beginning of the decade. Private consumption also fell (-9%), as did public consumption (-8%), and domestic demand therefore slunped by 14%. The embargo against the *defacto* re gime led to a 37% drop in export volume, which meant that in 1994 foreign sales were 40% lower :han they had been in 1991.

The supply of goods and services within the economy shrank by 17%, GDP plunged by 12% and the volume of imports contract ;d by 37%.

International trade sanctions wer Î tightened at the beginning of the year. This led to more frequent power outages and exacerbated the fuel shortage, which, in turn, prompted a drastic slow-down in production activities, particularly manufacturing. The lack of fuel and of imported inputs, especially fertilizers, compounded the structural problems which have plagued agriculture in Haiti for some time (such as soil erosion, a lack of credit and low investment levels), thereby driving the sector's output down by 8%.

Industrial production fell by 27%. The trade embargo had a devastating effect on the *maquila* (inbond assembly) industry, which, by the end of the fiscal year, had all but disappeared. In May 1994, this sector employed barely 8,000 people, compared to 44,000 in September 1991. During this same period, the number of business firms in operation tumbled from 252 to 44. Industries oriented towards the domestic market and import substitution were hurt by the contraction of local demand, the lack of imported intermediate goods, the meagre domestic supply of agricultural produce and competition from contraband goods.

The construction industry suffered a downturn equivalent to one-half its aggregate annual value, partly because of the suspension of public works due to budgetary constraints and partly as a result of sagging investment in housing owing to the financial squeeze and the rising cost of transport and building materials, particularly cement.

b) **Prices and employment**

Cumulative inflation over the preceding 12 months reached 52% in September 1994, an unprecedented level for Haiti and double the previous year's figure.

Some of the factors helping to fuel inflation were the expansion of the money stock and the reduction in supply caused by the slump in production activity and the trade embargo. Shortages of goods led to speculative purchasing and stockpiling, thereby triggering an inflationary spiral which was financed by the excess liquidity resulting from the expansion of the money supply. The devaluation of the local currency also contributed to the rise in prices by making imports more expensive. Rising food, fuel and transport prices were particularly significant factors in the overal increase in the general consumer price index.

What is more, the official figures may even underestimate the real rate of itiflation, in view of the proliferation of informal enterprises sparked by the breakdown of organized economic activity, the adverse market conditions existing for foreign trade, and the increase in illegal imports. It is likely that the consequent reduction of market transparency and competitiveness engendered wide price spreads, with prices being higher in informal transactions.

These circumstances also hal a social effect. The across-the-board rise in pricjs, especially for essential goods, eroded the purchasing power of wages. In 1994 the minimum vage once again dropped in value, this time by 2"% (as measured against the rise in the consumer price index). This was compounded by soaring unemployment, which reached an unprecedented level of over 60%. This situation inevitably forced large numbers of the unemployed to seek out alternative means of survival. Thus, traditional migratory flows from the country to the city reversed direction and a clandes ine exodus from the country gave rise to waves of destitute emigrants.

c) **The external sector**

For much of the year the most significant factor in terms of the external sector and the economy as a whole was the lightening of the international trade embargo in response to the failure of attempts to normalize the political situation in the country. It was r ot until October, when a constitutionally-based political solution had been found, that the sanctions began to be lifted.

The embargo accelerated the pre-existing trend towards a decline in the external sector's relative importance within the economy. In 1994 this sector accounted for barely 30% of GDP, compared with nearly 50% in 1Í'91 and over 60% in 1980. This type of process seriously undermines the mainstay of development in a small, outward-looking economy such as that of Haiti.

The value of exports fell by almost 40%, while the value of imports, f.o.b., went down by 35%. In absolute terms, however, the drop in the value of imports was much greater, and the country's persistent trade deficit consequently narrowed. The contraction in foreign sales extended to practically all sectors, with the exception of Haiti's negligible exports of sisal. The country's principal export products declined considerably. The subcontracting industry in the free trade area saw a 45% drop in sales, while exports of local crafts and cottage-industry manufactures plummeted by 55%. The preceding year, these two sectors had made a remarkable recovery and had accounted for more than two thirds of the total value of Haitian exports.

The embargo, the recession and the devaluation of the gourde explain the drop in registered imports, although there were signs of a surge in illegal imports. The (ifects of this decrease were felt the most in production-related industries: chemicals (-52%), manufactures (-40%), petroleum and petroleum products (-35%) and machinery and transport equipment (-28%).

The international sanctions hid an adverse effect on unrequited private transfer payments, which shrank by 40%. Nevertheless, the current account deficit fell from US$ 126 million to US$ 93 million, thanks to the steep reduction in imports. Income from net capital inflows stemming from the increase in humanitarian aid was insufficient to cover the deficit on current account and capital flight caused he country to lose some of its international reseives.

Despite the suspension of forñgn financial aid, accumulated arrears pushed the external public debt up to nearly US$ 8i'0 million, or slightly over 60% of GDP.

HONDURAS

1. General trends

In 1994 the Honduran economy felt the effects of a prolonged drought which hurt agricultural production and triggered critical electrical power shortages. The situation was made worse by a decline in the flow of external credit due to the country's failure to meet the conditions it had agreed upon with the International Monetary Fund (IMF). The combination of these two factors resulted in a drop of nearly 2% in gross domestic product (GDP), a considerable depreciation of the lempira, an acceleration of inflation to an annual rate of 29%, and a decrease in the country's already very low levels of personal consumption.

The slackening of domestic demand was accompanied by a reduction in tie volume of exports owing to a contraction in the available supply of Honduras' main export products. The foreign trade deficit none the less narrowed somewhat thanks to the fact that the rise in export prices outpaced the increase in impc rt prices. The resulting improvement in the terms < rf trade made up for the decline in production, and national income consequently remained une hanged.

2. Economic policy

The administration which took office at the beginning of the year formulated a policy designed to check the build-up of inflation that had begun the year before. However, the drought and the delay in concluding an agreement with the International Monetary Fund, which held up the country's receipt of external loans, made it much more difficult to attain this goal, particularly during the first half of the year.

Fiscal policy focused on reducing the budget deficit by cutting spending and instituting tax reforms aimed at boosting revenues. The privatization of the Empresa Hondurena de Telecomunicaciones (HONDUTEL) was also expected to bring in additional income. Although the effects of these reforms were not evident in the 1994 budget outturn because they were not passed until quite late in the year, the fact that the initial legislative steps had been taken enabled Honduras to reach an agreement with the International Monetary Fund (IMF) and obtain external credits from the Fund and other multilateral financial institutions, as well as to request the renegotiation of its debt with the Paris Club.

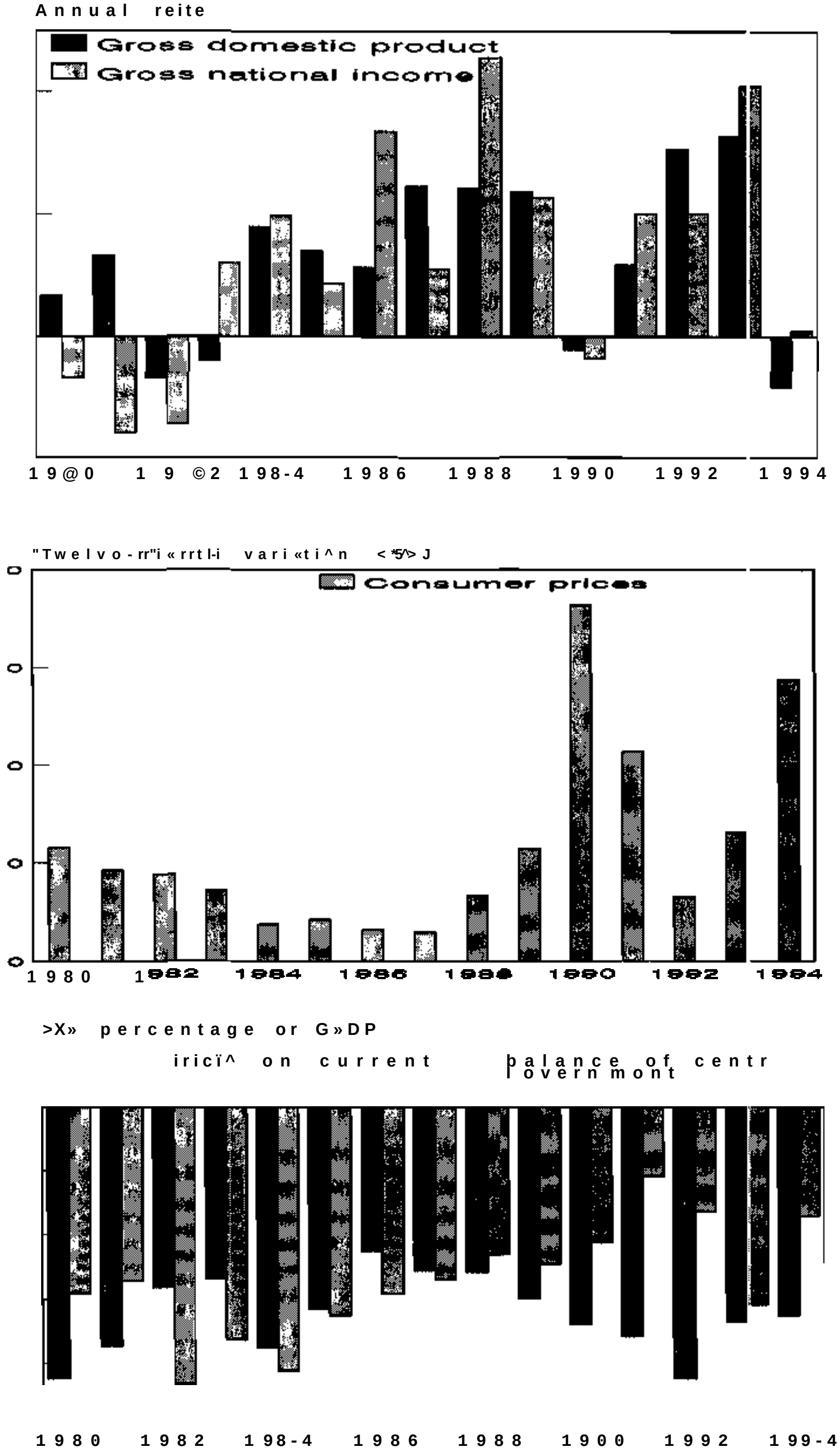
Monetary policy was aimed at curbing liquidity by raising the required level of interest-bearing reserves; neveitheless, the money supply expanded faster thin expected. Meanwhile, in response to the sharp change seen in the exchange rate during the first six months of the year, the Central Bank replao id the system of floating exchange rates with an auction-based scheme, an approach that helped to slow the depreciation of the lempira in the second half of the year.

Finally, in line with its current trade policy, Honduras became a member of the General Agreement on Tariffs and Trade (GATT) in April 1994.

a) Fiscal policy

The central objective of the administration's fiscal policy was to improve public finances, which had deteriorated during the pi eceding year due to the combined effect of a higher level of expenditure and a real reduction in income. The accomplishment of this objective ivas deemed

Figure 1
HONDURAS: MAIN ECONOMIC INDICATORS



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fundamental not only as one of the tools of a sound economic policy but also as a basic prerequisite for maintaining the flow of external capital from multilateral lending agencies.

The achievement of a positive level of current savings continued to be the country's chief fiscal-policy target. Under such a policy, the level of investment expenditure depends upon how much external financing is received. During the early months of 1994, however, spending levels continued along the upward path they had followed since 1993 due to the inertial component of expenditure generated by pre-existing spending commitments, wage hikes for public employees and hefty subsidy allocations. Nevertheless, subsequent measures did enable the central government to achieve current savings of around 1.4% of GDP and to reduce the overall deficit from 9% of GDP in 1993 to a little over 5% in 1994.

This accomplishment was made possible by a smaller increase in current spending and a reduction in capital expenditure, especially in investment by the central government, which fell by over 30% (around 10% in real terms). Despite this deep cut in real investment, the drop in capital expenditure was smaller because of the high level of financial investment. This, in turn, was a result of the outlays which the central government had to make on behalf of the Empresa Nacional de Energía Eléctrica (ENES) SO that an emergency electrical power generation project could be carried out in order to deal with the country's critical power shortages. To this same end, capital transfers to ENEE were also increased.

Current expenditure, which had climbed by 28% in 1993, rose by only 6% in 1994, for a 16% decrease in constant values. The two categories showing the largest increases were remunerations and debt interest. The growth rate registered for interest payments on the debt amounted to almost 50%, primarily as a result of the ascent of the exchange rate. In sum, the pressure exerted by expenditure eased from nearly 18% to 15.4% of GDP.

In an effort to boost income, in October a tax reform bill was submitted to the National Assembly that called for an increase in some taxes, the establishment of a number of new levies and a broadening of the t ix base. Under the provisions of these reforms, ¡i 1% tax on net corporate assets was levied for the twofold purpose of making the tax system more equitable and of countering income tax evasion with the help of an automatic control mechanism; the base for the sales tax was broadened by including services and eliminating Í number of exemptions; the income tax -a flit tax of 10%- was applied to interest income (in either local or foreign currency) from stock transactions, loans or deposits other than savings dc posits; the tax on private motor vehicles was raised; the excise tax on non-essential goods was consolidated at a 20% rate; a special taxation scheme was devised for coffee growers as a means of capturing part of the windfall profits afforded by higher coffee prices through the establishment of a two-year 5% tax on exports and a minimum income tax of 10% on windfall profits; and the customs valuation factor used in computing the tax base for foreign trade duties was replaced with the market exchange rate. In addition, a number of tariffs were consolidated, energy prices as well as telephone and electricity service rates were raised, and the subsidies formerly paid to producers of coffee, cement, wheat flour and petroleum products were discontir ued.

The full impact of these refonr s was not felt in 1994 because they were passed so late in the year. The annual growth rate for current income was also somewhat faster in 1994 tl ian it had been the year before owing to the increase in domestic prices, which boosted sales ta.c receipts in particular, and to the application)f the market exchange rate to dutiable items.

The deficit was financed almost entirely with external credit, which took off some of the pressure for the use of financial resources obtained from the sale of securities and the placement of loans by the Central Bank, an expedient which had been used extensively in 1993. Owing to these circumstances, the non-financial public sector's domestic debt held at virtually the same level as the y< ar before.

b) **Foreign exchange policy**

The reduction in inflows of exernal capital heightened the trend towards a depreciation of

Table 1

HONDURAS: MAIN ECONOMIC INDICATORS

	1987	1988	1989	1990	1991	1992	1993	1994[a]
				Growth rates				
Growth and investment								
Gross doemstic product	4.9	4.9	4.7	-0.4	2.3	6.1	6.5	-1.6
Per capita gross domestic product	1.7	**1.7**	1.6	-3.4	-0.7	3.0	3.4	-4.5
Gross national income	2.2	9.2	4.5	-0.7	4.0	4.0	8.2	0.2
Gross domestic product by sector								
Goods	4.9	4.1	8.2	-0.6	3.5	7.6	5.5	-4.1
Basic services	6.7	8.1	6.1	5.8	2.4	3.5	4.2	3.1
Other services	4.5	5.0	1.0	-1.7	1.1	5.2	8.3	
				Percentages				
Contribution to growth of GDP[C]								
Consumption	0.5	3.2	5.5	-2.7	1.8	4.1	4.8	-1.7
Government	0.8	1.2	0.4	-1.8	-1.2	1.3	0.5	-0.6
Private	-0.3	2.0	5.1	-0.8	3.0	2.7	4.2	-1.1
Gross doemstic investment	4.3	4.9	-0.8	0.6	3.6	2.9	4.3	-2.7
Exports	0.9	**-0.3**	1.6	0.2	-0.8	2.0		-0.4
Imports	-0.7	**-3.0**	-1.5	1.5	-2.4	-2.9	-2.5	3.1
				Percentages of GDP				
Gross domestic investment	17.5	21.4	19.6	20.4	23.5	24.8	27.4	25.1
National saving	6.0	**10.6**	9.1	11.1	12.8	11.8	13.9	16.1
External saving	11.5	**10.7**	10.6	9.2	10.7	13.0	13.5	9.1
				Percentages				
Employment and wages								
Activity rate								
Open unemployment rate[e]	12.1	8.8	8.4	8.0	7.1	6.4	7.5	8.1
Real minimum wage (Index: 1990 = 100)	98.3	**94.1**	85.7	100.0	100.1	113.4	115.4	94.8
				Growth rates				
Prices (December to December)								
Consumer prices	2.9	6.6	11.4	35.2	21.4	6.5	13.0	28.8
Wholesale prices	1.5	10.7	20.4	41.3	20.4		19.0	35.1
External sector								
Terms of trade (Index: 1990=100)	93.4	103.4	102.0	100.0	106.2	101.7	102.5	104.0
Nominal exchange rate (lempiras per dollar)	2.00	2.00	2.00	4.10	5.32	5.51	6.59	8.63
Real effective exchange rate (Index: 1990=100)	60.3	60.4	56.1	100.0	107.9	102.4	112.6	125.3
				Millions of dollars				
Balance of payments								
Current account	-330	-318	-329	-282	-317	-413	-464	-319
Trade balance (goods and services)	-122	-113	-123	-91	-120	-188	-264	-161
Exports	950	1026	1 061	1032	1 016	1 041	1 067	1 110
Imports	1072	1139	1184	1124	1135	1229	1331	1271
Capital account	395	333	300	307	383	424	319	352
International reserves (variation)	26	-19	-28	18	65	**24**	-104	45
				Percentages				
External debt								
Gross debt (as a percentage of GDP)	87.3	92.1	92.2	127.8	107.9	109.3	120.9	139.3
Net interest (as a percentage of exports)[8]	17.8	16.7	16.6	17.2	20.2	25.1	22.8	17.2

Table 1 (conclusion)

	1987	1988	1989	1990	1991	1992	1993	1994[a]
	Percentages of GDP							
Central Government								
Current income	17.5	15.0	14.7	16.4	17.4	17.4	16.8	16.8
Current expenditure	20.2	17.4	17.9	17.2	16.5	16.6	17.8	15.4
Saving	-2.7	-2.4	-3.1	-0.8	1.0	0.8	-1.0	1.4
Capital expenditure (net)	5.4	4.5	4.2	5.6	4.3	5.7	8.3	6.6
Financial balance	-8.1	-6.9	-7.4	-6.4	-3.3	-4.9	-9.3	-5.2
Domestic financing	3.6	2.6	4.1	-1.2	-3.3	-2.9	-0.4	0.2
External financing	4.5	4.3	3.2	7.5	6.6	7.8	9.7	4.9
	Growth rates							
Currency and credit								
Monetary balance of banking system								
Net international reserves					-327.0	236.3	-70.2	38.3
Domestic credit					3.7	2.9	35.2	21.1
To the public sector		...		...	-56.8	-23.6	11.6	34.2
To the private sector					16.5	24.8	14.9	24.7
Money (Ml)	...				16.8	14.2	13.0	37.0
Savings and time deposits (in local currency)					23.0	34.2	5.3	10.1
M2					20.0	24.7	8.7	22.3
	Annual rates							
Real interest rates (annualized)								
On deposits	...	1.9	-2.6	-20.0	-7.6	5.5	-1.1	-13.1
On loans		8.2	3.5	-13.9	1.1	14.3	8.1	-3.0
Equivalent interest rate in foreign currency		8.6	8.6	-50.1	8.6	4.9	-9.6	-12.7

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. Based on 1980 dollars at constant prices. [c] These entries measure the impact > >f the variation in each aggregate on the variation in GDP. Percentages of the working-age population.. [e] Open unemployment rate in Tegucigalpa. The figures shown for 1993 and 1994 refer to the variation registered for the fourth quart :r as compared to the corresponding period of the preceding year. [8] Refers to net interest as shown on the balance of payi nents, divided by exports of goods and services. The interest rate after it has been deflated by the variation in the average exchange rate offered by banks for cash transactions.

Table 2
HONDURAS: MAIN QUARTERLY INDICATORS

	1992				1993				li'94"			
	I	II	III	IV	I	II	III	IV	I	II	III	IV
Consumer prices (12-month variation, %)	13.1	7.9	6.1	6.5	7.3	10.3	13.2	13.0	16.5	21.7	24.1	28.8
Real effective exchange rate (Index: 1990=100)	100.2	100.0	102.4	107.0	105.2	110.9	115.1	119.3	120.4	129.3	127.5	123.9
Real interest rate (annualized)												
On deposits	5.9	3.9	1.0.5	1.7	1.9	-5.6	-2.8	1.9	-9.8	-20.8	-9.4	-12.3
On loans	15.5	12.7	19.7	9.5	10.3	2.1	7.2	12.9	-0.5	-12.3	1.1	-0.3

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures.

the lempira, which had been allowed to float against other currencies since the beginning of the 1990s. In an effort to slow the exchange rate's ascent, midway through the year the Central Bank consolidated the interbank market and instituted a system based on foreign exchange auctions. Under this system, the Central Bank bought hard currency from its exchange agents at the market's reference rate and auctioned it off to buyers whose bids had to be within 1% of the benchmark exchange rate, which was set by the Central Bank based on the reference rate.

The Bank's intervention in the exchange market and the restriction of bids to a maximum variation of 1% every 15 auctions gave the foreign exchange market greater stability; as a result, the rate for the dollar climbed only 8% during the second half of the year, as compared to nearly 20% during the first half.

c) **Monetary policy**

As a consequence of the build-up in international reserves, an increase in Central Bank credit to the public and private sectors, and para-fiscal expenditures, the monetary base expanded by about 45% during the year. In order to reduce the system's liquidity, in June the minimum reserve requirement wa s raised to 40% for commercial banks and 23 *Jo* for savings institutions. A portion of these reserves took the form of interest-bearing government securities.

Thanks to the use of these mechanisms of monetary absorption, the money supply expanded less (37%) than the monetary base did, although its growth rate was still well above the rates for preceding years. Under these circumstances, even though nominal interest rates on deposits and on loans w;re raised, they both declined in real terms. Given the real decrease in rates on deposits, local-currency term deposits were not very attractive and thus increased by only 10% in naminal terms. Consequently, the expansion of the broad money aggregate (M2) was on the order of 22%, and bank credit to the private sectcr climbed at a similar rate.

A steady increase was seen di ring the year in unregulated types of financial institutions, which, by the same token, are not subject to minimum reserve requirements According to official estimates, the amount of jiinds channeled through these intermediaries wis equivalent to one fourth of the money supply.

3. **The main variables**

a) **Economic activity**

After two years of strong growth (at annual rates of over 6%), in 1994 the economy's gross domestic product (GDP) shrank by nearly 2%, which translated into a decrease of approximately 5% in per capita GDP.

With the exception of private investment, which rose for the third year in a row at an annual rate of 9%, the drop in aggregate demand occurred across the board. Both public investment -which had been the mainstay of the country's economic growth during the two preceding years- and government consumption were lower as a result of the administration's policy of narrowing the fiscal deficit, while, given the decrease in real wages, private consumption contracted at much the same rate as GDP. Meanwhile, the volume of exports was down due to a decline in shipments of the country's main export products.

The economy's weak performance was partly attributable to the prolonged drought, which drove down agricultural output and heightened the shortfall in electrical power generation. In response to the resulting energy crisis, electricity was rationed throughout much oJ the year, which hurt the manufacturing sector. In addition, the cutback in public investment had a severe impact on construction and on the suppliers of some of the construction sector's inputs, which had been expanding at a striking pace for the past two years. Almost all the remaining sectors of activity contracted as well, with the exception of mining and some services representing a very small share of total production.

The agricultural sector slumpi ;d by nearly 3%. Production for the domestic market was hurt by the drought, which cut the corn h arvest by almost

25%. The showing of export-oriented agriculture was similarly lackluster. The supply of bananas decreased as producers were discouraged by lower prices on the United States market, restrictions imposed on Latin American exports by the European Union and the calling of a strike at mid-year in one of the main production companies. Furthermore, coffee growers, whose plantations have been allowed to deteriorate, were unable to respond to the upturn in international prices.

The livestock industry made some headway, but forestry activities experienced a slow-down due to the imposition of a partial ban designed to block unsound practices in the development of forest resources. The fishery sector had done well during the past three years, but registered a downturn in output for 1994. The shrimp industry, which had been expanding steadily for a decade, was ravaged by a disease similar to the Taura syndrome that struck Ecuador's shrimp farms in 1993, causing its exports to plunge to almost half their former level.

Construction, which had grown at an extremely rapid pace in 1992 and 1993, slumped by 17% owing to a decrease in public-sector building and to a shortage of cement that drove up its price and thus increased construction costs substantially. The occurrence of a cement shortage at a time when production was on the rise was accounted for by the fact that a large percentage of output was channeled to the external market.

The slow-down in manufacturing (-2%) was partly a consequence of the rationing of energy supplies, which compounded the effects of weaker domestic demand and limits on credit. In 1994 net electricity generation was 8% below the 1993 figure; this level of output, plus imports, made for a total supply of 2,300 MWh. Since this was clearly not enough to meet a potential demand for 2,800 MWh, rationing became necessary. Almost 70% of all manufacturing enterprises had to buy generators in order to meet their own energy needs, but this increased their costs, since the price per kWh of power supplied by ENEE was 50% less than the cost to such firms of generating their own supply. With the exception of petroleum products, wood and wood products, and non-metallic minerals (especially cement), most branches of irdustry saw a decrease in activity.

In the time that had passed sine e the Francisco Morazán hydroelectric plant cam* on stream, not only had the country's effective installed capacity failed to increase, but it had actually been diminishing as a consequenc e of a failure to maintain some thermal power plants in good condition and the closure of othîrs. The result was a heavy dependence on hydro îlectric power. Irregular rainfall in the past few y< ars and a rapid deforestation process combined lo lower water levels in the reservoirs used by hydroelectric plants, and the amount of power bîing generated was therefore dropping at a time when demand was growing. A number of them al plants were brought on line in order to deal wil h this problem and, although their costs were higiier, by the end of the year it became possible o discontinue rationing.

b) **Prices, wages and employment**

Continuing a trend begun ii the second quarter of 1993, the rate of increase in the consumer price index accelerated r larkedly, with the annual rise (December to Decei nber) jumping from 13% in 1993 to 29% in 1994. The largest increase -more than twice as much as the year before- was in the category of fc od. A similar rate was registered for health care, but this category carries a lower weightin 5 in the basic shopping basket. In contrast, tie price rises recorded for clothing, education, reading materials and entertainment, and beverages and tobacco were lower than the in;rease in the overall index.

This price trend was primarily iccounted for by the rising exchange rate, a shortfall in the supply of basic grains caused by a reduction in domestic supply, and increases in the prices of petroleum products and urban transport. In November the Government reached an agreement with entrepreneurs for tie imposition of temporary price controls on 40 ;ommodities. These controls remained in force through December but their effectiveness proved to be somewhat limited.

Given the rigidity of economic agents' perceptions in the face of an upsurge in inflation, real wages fell by 18%. Under these circumstances, which were exacerbated by rising urban unemployment (in Tegucigalpa the level of unemployment was over 8% of the active population), strikes were called and demonstrations were held. The minimum wage, which had not been raised since mid-1993, remained unchanged because the Government and workers failed to reach an agreement. The authorities dealt with this situation by unilaterally announcing that a 20% increase in the minimum wage would take effect in 1995.

c) **The external sector**

The higher value of exports, lower imports and a smaller trade deficit for services all helped to cut the deficit on the current account of the balance of payments to US$ 320 million. Nevertheless, the deficit was still quite large, since it was equivalent to one third of the country's exports of goods and services and to over 10% of GDP.

The fact that export prices rose more sharply than the prices of imports led to an improvement in the real terms of trade for goods, and this meant that the purchasing power of exports held its ground despite a drop in export volumes. The rise in prices boosted the current value of merchandise exports by more than 2%.

All the country's main exports (including both traditional and non-traditional products) enjoyed higher unit values with the exception of bananas, whose price slipped by 12%. The increases seen in coffee prices (52%) and, to a lesser extent, in the prices brought by silver (25%) and shrimp (24%) were particularly noteworthy. On the other hand, the volume of banana exports fell yet again in response to flagging demand in the European market and lower prices in the United States market. The further increase in the value of shrimp exports, which has been mounting rapidly in recent years, was attributable to higher prices, since the volume of sales was down. Producers were unable to respond to soaring coffee prices by increasing their exports due to the timing of the coffee harvest. The *maquila* (inbond assembly) industry, which had been booming since 1991 and had nearly trebled its aggregate value at current prices during that time, experienced a slow-down in 19<>4 due to labour problems.

In this sluggish economic environment, the value of merchandise imports i ell by over 6% owing to a reduction in purchas es of consumer and intermediate goods from abroad. Imports of petroleum and petroleum products gathered momentum as it became necessaiy to use thermal plants and generators to produce more electrical power, but the increase was almo st entirely offset by the drop in hydrocarbon prices on the international market. Purchases of capital goods -especially the acquisition of electrical power plants by both private agents and the public sector- expanded for the same reason.

Trade with the rest of Central America had been growing since April 199:5 thanks to the creation of a free trade area. Merchandise exports to the other Central American countries rose by 25%, which was similar to the growth rate for the year before. Because the need to purchase electrical power caused imports to continue to rise fairly sharply, however, Honduras' trade deficit with the rest of the subregion widened.

Factors playing a decisive rele in narrowing the trade deficit on the services account included the relatively low level of interest rates in international markets and some advances in the renegotiation of the country's debt, which cut its interest payments by some US$ 50 million.

Delays in signing a letter of in tent with the IMF were one of the reasons for the reduction in loans from the Inter-American Development Bank (IDB) and the World Bank, whicli withheld funds that had been earmarked for the agricultural and energy sectors. This situation was reflected in a decline in the inflow of long-ten *a* capital despite the higher level of direct investments received by the country, which totalled US$ 55 million. Grants and donations were also down from the year before. These difficulties in obtaining external capital were one of the factors behind a moratorium on roughly US$ 100 million in interest payments, which was equivalent to one half of the country's total interest bill. Since the total sum of interest due and payable is entered on the current account, the capital account registers a matching amount of short-term involuntary financing.

The decrease in multilateral loans slowed the expansion of the external debt to just 3%, which was far below the rates recorded during the two preceding years. Even so, the external debt was well above the level of GDP and amounted to more than three times the value of the country's exports. A breakdown of the debt by type of creditor reveals that the share of bilateral and multilateral agencies held fairly steady at around 32% and 55%, respectively. The country's largest creditor was the IDB, which accounted for about one fourth of the debt, followed by the World Bank with a little over 20%.

In an effort to ease the burden cf external debt payments, the country was striving to improve its debt profile with the IDB by replacing hard loans with softer loans from the Futid for Special Operations. Honduras' agreement with the Paris Club had technically been suspended in August 1993 subject to its signature of a letter of intent with the IMF and the payment of its arrears. When an arrangement was made with t le IMF, it was agreed that talks with bilateral a editors would begin in mid-1995. Honduras piarned to request that between 50% and 65% of ils debt, which amounted to US$ 1.058 billion, tx forgiven.

MEXICO

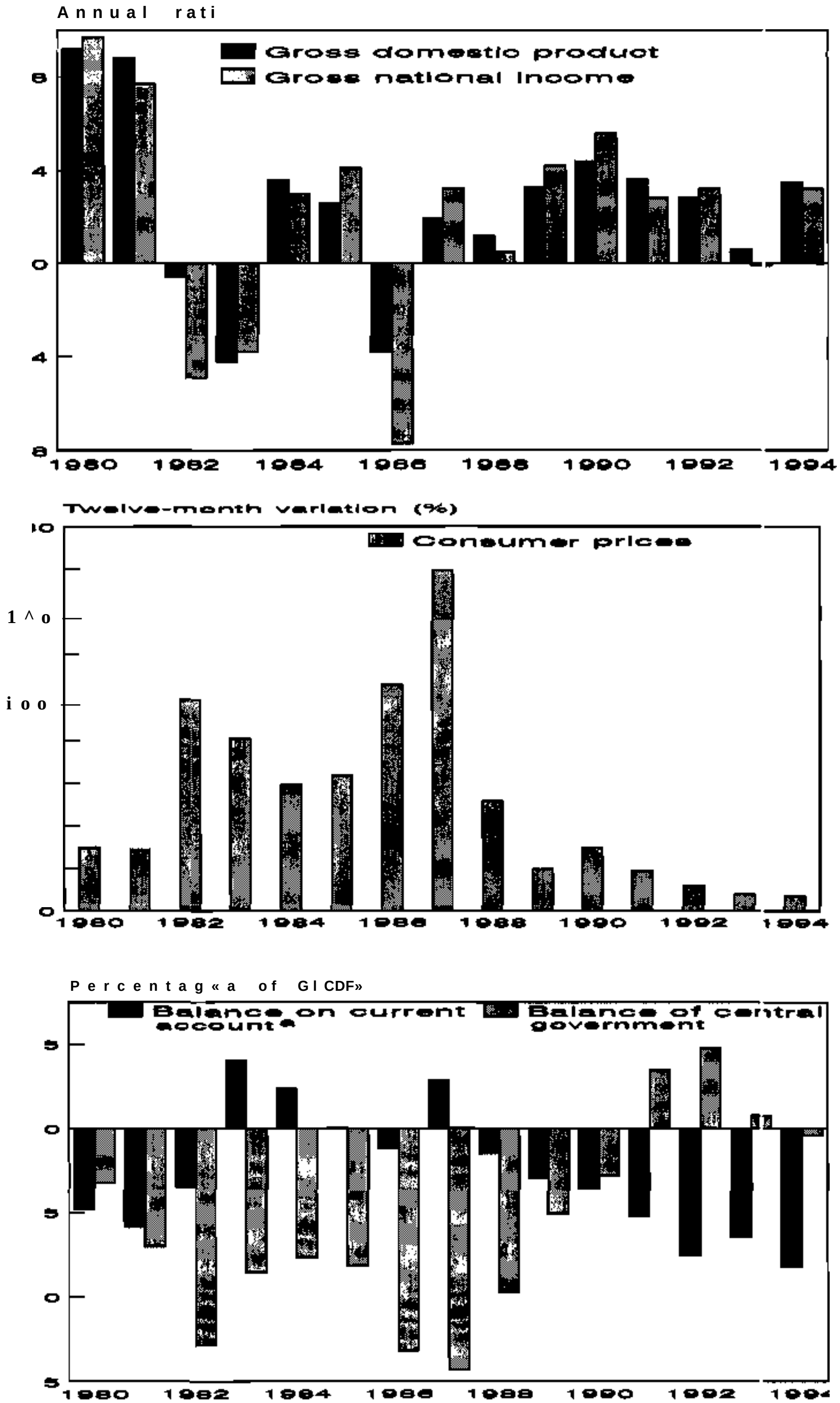
1. General trends

In 1994 the Mexican economy was beset by a marked degree of uncertainty and was particularly affected by a number of crucial political events. Trends in the leading variables were in keeping with the Government's economic programme for most of the year, but the external sector's cumulative imbalances, the implementation of an expansionary monetary policy at a time when reserves were being drawn down, and a number of serious political developments all combined to set off a major crisis in the last 10 days of December. Economic growth sped up to an annual rate of 3.5% after two years of meagre results. The rate of inflation, whose reduction remained the economic programme's main objective, continued to fall, reaching just 7% per annum -the lowest rate in 20 years. The non-financial public sector, for its part, was unable to reproduce the strong performance it had turned in during the preceding three years -when its accounts alternated between balance and surplus- but did manage to hold its deficit to less than 1% of gross domestic product (GDP). Other developments were less positive, however. In particular, the deficit on the balance-of-payments current account widened to US$ 29 billion, or almost 8% of GDP, and the flow of external resources, which in past years had more than covered this deficit, began to exhibit fluctuations that made it necessary for the country to draw down its international reserves. Furthermore, on the assumption that both the outflow of foreign exchange and the higher level of uncertainty in the economy were only temporary trends which would reverse their course once the elections were over -in view of the firm support forthcoming from Mexico's partners in the North American Free Trade Agreement (NAFTA) and the new prospects opened up by economic integration- an expansionary monetary policy vas adopted. Finally, domestic borrowing inci eased, at the same time as debt maturities were shortened and the face value of debt instruments 'vas pegged to the exchange rate in an effort to reduce the uncertainty prevailing in financial markets.

Owing to the fact that in recent years the flow of external resources had contain ;d increasing amounts of highly volatile short-term financing, the confidence level of economic agents came to have a major impact on the net balance of external finance. The series of decisive political events that occurred in 1994 in th; midst of an electoral process that was bound to lead to a change of administration in the near future -together with the existence of esternal, credit and banking disequilibria- heightened the uncertainty of economic agents an! generated a persistent outflow of short-term capital at a time when, for the most part, short-tern government securities were not being rolled over. This outflow swelled dramatically during the final 10 days of 1994, resulting in international reserve losses of about US$ 19 billion lor the year. Meanwhile, after the Banco de México first raised the ceiling of the exchange- rate band for the dollar by 15% and then withdiew from the foreign exchange market altogether, the exchange rate for the United States dollar began to climb steadily.

At the year's close, the upsurge il i commercial bank portfolios of overdue loins and the uncertainty prevailing in financial markets gave grounds for concern that the level of international reserves might be insufficient to cover external debt maturities. Against this background, in the first months of 1995 currency arid financial markets exhibited a high degree of volatility and, in response, the authorities launched a strict programme of fiscal adjustment and monetary

Figure 1
MEXICO: MAIN ECONOMIC INDICATORS



8our«?w: ECLAC, on tine basis of official fl£
- Of the balance of payments.

control. Emergency talks were held with the United States and a number of international agencies, and the outcome of these negotiations was an unusually large bail-out package of loan guarantees. Since financial and exchange-rate instability persisted, however, a new set of restrictions was put into effect in March, when the exchange rate for the dollar was more than twice as high as it had been prior to 20 December 1994. Domestic prices reacted rapidly, and by June the rate of inflation for the previous 12 months had risei to 38%. In addition, such an abrupt turnaround was seen in the trade balance that in the first quarter the country actually posted a surplus in its merchandise trade. This set of circumstances dampened the level of economic activity, thus bringing the incipient recovery observed the year before to a halt. The unemployment rate also moved upward.

2. **Economic policy**

Economic policy-makers had to come to grips with the problems arising out of the country's mounting external imbalances and the uncertainty and other negative effects brought on by a number of major political events, including the electoral process, which came to a head in August. On the one hand, the current account deficit continued to widen and adverse expectations as to the feasibility of financing this deficit -and, hence, the viability of the exchange-rate regime- intensified among a growing number of economic agents within an economic environment marked by rising interest rates in the United States, stiffer competition from other emerging markets and a high -and in some cases the highest ever- level of exposure in terms of holdings of Mexican securities in foreign portfolios. On the other hand, a string of political events and acts of violence on the domestic front, including the assassination of the governing party's presidential candidate, undermined investors' confidence.

All these developments caused a marked slow-down in inflows of capital from abroad, and this, in turn, helped to keep the exchange rate very close to the upper limit of the currency band, especially after the first quarter, as well as to deplete international reserves, which fell from around US$ 29 billion in mid-February to around US$ 12 billion in late November.

In the face of these circumstances (which the authorities believed to be only temporary), from the second quarter onward monetary policy-makers focused on offsetting the downturn in the flow of resources from abroad by expanding the supply of domestic credit without making any changes in the exchange-rate system, which served both as an anchor for the 3overnment's anti-inflationary policy and as <i contributing factor in the stability of local finaicial markets. By means of this approach, the authorities sought to sustain the pace of the recovery being made by production activity, which, in spite of the various negative political developments troubling the country, was beginning to shaw signs of considerable strength after having come to a virtual standstill the year before.

At the same time, emphasis continued to be placed on the Government's ami-inflationary policy, whose principal aim was lo achieve an inflation rate comparable to that of Mexico's main trading partners based on a îliding-parity system under which adjustments were to be announced beforehand. The focus o f fiscal policy continued to be on achieving a bal meed budget within an economic environment in which the reduction of the service on Mexico's external public debt enabled the Government to increase its expenditure levels, especially i;i the area of social development.

The Banco de Mexico's use of open market operations, combined with the support of a contingency fund set up by the Unit ;d States and Canadian Treasuries (based on a seies of swaps involving several billion United Stites dollars), staved off a further drop in international reserves during the second and third quart ;rs. Another factor mitigating the destabilizing *t* ffects of the prevailing situation was the preservation of an economic and social consensus through the reaffirmation on 1 January and igain on 24 March of the commitment made on 3 October 1993 to reduce inflation and to raaintain the controlled float of the currency.

Table 1
MEXICO: MAIN ECONOMIC INDICATORS

	1987	1988	1989	1990	1991	1992	1993	1994[a]
	Growth rates							
Growth and investment								
Gross domestic product	1.9	1.2	3.3	4.4	3.6	2.8	0.6	3.5
Per capita gross domestic product	-0.2	-0.7	1.4	2.5	1.7	0.9	-1.2	1.7
Gross national income	3.2	0.5	4.2	5.6	2.8	3.2	-0.1	3.2
Gross domestic product by sector								
Goods	2.9	0.9	3.8	5.8	2.9	2.3	0.3	3.5
Basic services	3.1	3.0	4.8	5.9	5.3	6.8	3.5	7.8
Other services	1.0	1.3	2.8	3.3	4.0	2.7	0.7	3.0
	Percentages							
Contribution to growth of GDP[c]								
Consumption	-1.0	2.0	4.6	4.2	3.5	3.9	-0.1	3.0
Government	-0.1	-0.1	0.0	0.3	0.4	0.2	0.2	0.3
Private	-0.8	2.0	4.6	3.9	3.0	3.6	-0.3	2.8
Gross domestic investment	0.9	1.9	0.8	1.9	1.4	2.8	-0.7	1.6
Exports	2.2	1.0	0.8	0.7	1.1	0.2	1.1	2.0
Imports	-0.3	-3.6	-2.8	-2.4	-2.4	-4.1	0.3	-3.2
	Percentages of GDP							
Gross domestic investment	15.9	17.6	17.8	18.9	19.6	21.8	21.0	21.9
National saving	18.0	16.3	15.0	15.3	13.8	12.5	12.4	11.9
External saving	-2.1	1.3	2.8	3.6	5.8	9.3	8.6	10.0
	Percentages							
Employment and wages								
Activity rate	51.1	51.6	51.8	51.8	53.3	53.8	55.2	54.6
Open unemployment rate[e]	3.9	3.6	3.0	2.8	2.6	2.8	3.4	3.7
Real minimum wage (Index: 1990=100)	140.0	124.5	114.6	100.0	94.5	91.3	90.3	90.1
	Growth rates							
Prices (December to December)								
Consumer prices (nation-wide)	159.2	51.7	19.7	29.9	18.8	11.9	8.0	7.1
Wholesale prices (Mexico City)	164.6	42.6	18.1	27.4	15.7	10.7	7.4	7.8
External sector								
Terms of trade (Index: 1990=100)	92.3	88.6	94.6	100.0	94.9	96.2	97.4	97.0
Nominal exchange rate (new pesos per dollar)	1.38	2.27	2.46	2.81	3.02	3.09	3.12	3.38
Real effective exchange rate (Index: 1990=100)	135.2	110.0	103.2	100.0	91.1	84.1	79.8	82.1
	Millions of dollars							
Balance of payments								
Current account	3 983	-2 544	-5 977	-8 747	-14 995	-24 919	-23 487	-29 165
Trade balance (goods and services)	9 125	2 617	-67	-2 803	-9 028	-18 231	-15 156	-20 714
Exports	27 508	28 954	33 030	38 411	39 696	41449	44 799	50 077
Imports	18 383	26 337	33 097	41214	48 724	59 680	59 955	70 791
Capital account	1602	-4 094	6 154	11050	22 988	26 664	30 719	10 282
International reserves (variation)	5 758	-6 788	120	2 019	7 619	1934	7 291	-18 883
	Percentages							
External debt								
Gross debt (as a percentage of GDP)	72.5	58.3	46.3	41.9	40.0	34.6	35.4	37.2
Net interest (as a percentage of exports)	22.9	21.3	20.4	17.2	16.1	18.2	19.7	18.6

Table 1 (conclusion)

	1987	1988	1989	1990	1991	1992	1993	1994[a]
	Percentages Of GDP							
Federal government sector								
Current income	17.2	16.8	17.9	17.1	17.0	17.7	17.3	17.1
Current expenditurre	28.3	24.6	21.0	17.3	15.0	13.7	15.0	15.5
Saving	-11.1	7.8	-3.1	-0.2	2.0	4.0	2.3	1.6
Capital expenditure (net)	3.2	1.9	2.0	-3.0	-1.5	-0.8	1.5	2.0
Financial balance	-14.3	-9.7	-5.1	2.8	3.5	4.8	0.8	-0.4
	Growth rates							
Currency and credit								
Monetary balance of banking system				44.5	40.6	19.4	14.1	38.0
Net international reserves				71.3	79.9	7.3	31.9	-57.0
Domestic credit	104.4	66.9	45.6	41.7	35.6	21.4	11.5	54.6
To the central government (net)	78.5	70.1	13.5	17.7	-2.5	-51.9		
To the private sector	158.1	82.9	97.6	73.5	61.5	47.7	24.3	40.4
Money (Ml)	120.8	65.8	38.6	64.7	124.8	14.7	17.9	1.1
Savings and time deposits (in local currency)	144.5	37.5	43.7	41.4	20.2	24.1	12.3	35.3
M2	141.0	42.2	43.0	46.2	47.2	20.4	14.4	22.7
Dollar deposits	240.7	-4.2	69.8	10.6	9.8	28.6	12.3	89.9
	Annual rates							
Real interest rates (annualized)								
On deposits (30-day)		7.3	13.8	1.0	-1.3	3.4	6.9	5.8
Equivalent interest rate in foreign currency (30-day)		42.6	18.2	17.2	12.2	14.0	15.9	-8.5

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Based on 1980 dollars at constant prices. [c] These entries measure the impact c f the variation in each aggregate on the variation in GDP. The coefficients were obtained by multypling each aggregate's annu il growth rate by the level of that aggregate as a percentage of GDP. Percentages of the working-age population. " P îrcentages of the economically active population. Interest rate on deposits, deflated by the variation in the exchange rate

Table 2

MEXICO: MAIN QUARTERLY INDICATORS

	1992				1993				1994[a]			
	I	II	III	IV	I	II	III	IV	I	II	III	IV
Gross domestic product (Index: 1990=100)	103.3	108.4	103.5	110.9	105.8	108.6	102.6	111.9	106.5	113.9	107.3	116.4
Consumer prices (12-month variation, %)	16.9	16.0	15.5	11.9	10.6	10.0	9.6	8.0	7.1	6.8	6.7	7.1
Real exchange rate (Index: 1990=100)	89.5	88.8	88.9	86.0	79.8	80.5	79.9	79.0	77.2	81.2	82.9	87.1
Real interest rate (annualized, %) On deposits[c]	-3.0	3.5	7.2	5.9	7.0	8.6	6.1	5.8	1.1	8.6	7.6	5.9
Money supply (Ml) (12-month variation, %)	111.5	105.2	64.5	14.7	19.1	18.4	22.0	17.9	20.0	9.8	8.4	1.1

Source: ECLAC, on the basis of official figures.
Preliminary figures. On the basis of non-seasonally adjusted series at constant Mexican prices.)0-day deposits.

However, the sharp increase in the circulation of *Tesobonos* (dollar-denominated bonds), which had initially helped to ease pressure on the peso, subsequently had a perverse effect. Beginning in April, the financial authorities engineered the replacement of *Cetes* (treasury certificates), *Bondes* (development bonds) and *Ajustabonos* (adjustable-rate bonds) with, for the most part, *Tesobonos*, an instrument in circulation since 1991 whose value is indexed to the exchange rate. This move had a far-reaching impact. Investors drastically reduced their holdings in peso-denominated securities, while the value of total *Tesobonos* issues rose from just under US$ 2 billion in April to US$ 29 billion by the end of December, as funds released by the retirement of *Cetes* and other debt instruments were channelled into the purchase of these securities. The enormous quantity of *Tesobonos* in circulation, together with commercial banks' external liabilities, served to heighten doubts as to the viability of the exchange-rate regime in view of the potential demand for foreign exchange entailed by these instruments' short-term maturities.

During November and the first half of December, international reserves declined even further (US$ 5 billion), after having held fairly steady between April and October at around US$ 17 billion. The new administration, which took office on 1 December, decided to raise the ceiling of the currency band by 15%. This step, taken on 20 December, touched off a widespread crisis in the confidence level of economic agents and a massive outflow of capital; just two days later, this situation forced the authorities to alter their exchange-rate strategy by instituting a clean float of the peso in an effort to protect existing reserves. Against this backdrop, during the last week of December the exchange rate jumped to a level 67% higher than the rate registered at the start of the month; interest rates shot up and financial markets became highly volatile.

By year's end, international reserves only amounted to slightly over US$ 6 billion. Under these circumstances, the service on the external public debt, the huge amount of *Tesobonos* scheduled to mature in 1995 (US$ 17 billion of which were held by non-residents) and the commercial banking systeri's short-term external obligations (US$ 15 billion of which were to fall due in 1995) add&l to the level of uncertainty and put extremely heavy pressure on the foreign exchange market.

In order to head off further instability and restore investors' confidence, a harsh adjustment programme was implemented n early January 1995. The programme was des gned to prepare the economy for the smaller J low of external financing projected for 1995 as well as the externally-imposed conditions contained in the agreements which the country r ad reached with the United States and the International Monetary Fund (IMF). The Programme had three main objectives: to reduce the current account deficit to manageable levels; to ensure that the inflationary impact of the devaluation would be as slight and as short-lived as possible; and to re-establish the conditions necessary for economic recovery.

The most notable features of the Government's economic policy was its abandonment of the system of currency bands and the adoption of an extremei y tight monetary policy as one of the cornerstones of its stabilization and adjustment piogrammes. The Banco de México set a limit oi US$ 10 billion new pesos on the expansion of its net domestic credit. In keeping with this measure, a contractive fiscal policy was implemented which called for spending cutbacks and increases in the prices and rates charged for the goods and services provided by the public sector. In addition, it was announced that a new privatization drive would be launched and that private investors would be allowed into sectors which they had previously been prohibited from entering, such as railways, telecommunications, ports and airports.

The collapse of the peso in December added urgency to talks aimed at seeking out international support that would enable Mexico to find an immediate solution to the crisis. In late January 1995, the authorities announced that a foreign loan package totalling over US$ 50 billion had been put together by the United States Exchange Stabilization Fund, the IMF, the Bank for International Settlements and commercial banks. Because the relevant markets had already partially discounted the effect of this support mechanism, Mexico's financial instability persisted in the following weeks; another factor in this regard was that the goals set forth by the adjustment programme with respect to growth, inflation, interest rates and the exchange rate were seen as being unrealistic.

For this reason, in March 1995 the authorities introduced new economic adjustment measures. The principal objective was to stabilize financial markets in the short term, especially the foreign exchange market (the interbank exchange rate for the dollar reached a high of 8 new pesos early in March); a great deal of importance was also attached to strengthening domestic saving. The fiscal measures that were adopted included public-sector price and rate hikes; an increase in the value-added tax (VAT) rate from 10% to 15% as of April 1; and additional cutbacks in public spending equivalent to 0.3% of GDP, bringing the adjustment for the year to 1.6% of GDP. The expectation was that this reduction in public spending and the increased revenues from the VAT would boost the primary surplus from 2.3% to 4.4% of GDP. Support for savers and for commercial banks experiencing difficulties in connection with capital formation was another important feature, given the increase in overdue loan portfolios and the size of most institutions' foreign debts.

a) **Fiscal policy**

The Government's main policy objectives for 1994 were to consolidate the progress made in putting public finances on a sounder footing, to support sectors where State participation was more effective from a social standpoint, and to make use of budgetary savings made possible by past adjustment measures to bolster the country's economic recovery, without, however, impairing its fiscal discipline.

With a view to these objectives, and within the framework of the Stability, Competitiveness and Employment Pact (PECE) and the general economic policy approach taken in 1994, the composition of expenditure was s lifted towards more social spending, and income taxes were reduced. In addition, the collection of other revenues was stepped up; in some cases this was done purely for fiscal purposes, and in others -e.g., the prices of goods and sen ices provided by the State- there was the furthe r objective of correcting price lags. A number of measures designed to benefit wage-e irners were introduced, including a reduction ii i income taxes for workers earning up to fair times the minimum wage, income-tax exïmptions for persons earning up to two times the minimum wage, and an added allowance for workers earning the equivalent of the minimum wage or less.

As a result of this policy, expenditure rose by 8% in real terms, which was doubla the increase in income. Thus, the financial sur plus obtained in 1993 (equivalent to 0.7% of GDP) gave way to a small deficit (0.3% of GDP).[2] This turnaround was attributable to the federal government -which had posted a surplus of around 0.4% of GDP in 1993 but recorded a deficit o f 0.8% of GDP in 1994- since all the other oficial sectors continued to have surpluses comparable to those of the preceding two years. Meanwhile, public-sector financial intermediaries (development banks and various special funds) contributed to the reactivation policy by once again running a cash deficit, which on this occasion was equivalent to 3.6% of GDP and was covered primarily with external resources.

Total public-sector outlays amounted to 27% of GDP, chiefly as a consequence of the 11% real increase in federal government expenditure. A sizeable expansion was observed in transfer payments (24%) owing to increased contributions for federal agencies involved in providing basic education services (12%), for rural producers through the Rural Assistance Programme (PROCAMPO), and for rural development programmes (54%). The wage

[1] **The loan package, in its original form, totalled US$ 50.75 billion (US$ 20 billion from the United S tates Exchange Stabilization Fund, US$ 17.7 billion from the MF, US$ 10 billion from the Bank for International Settlements ai d US$ 3 billion from international commercial banks; this last component was subsequently dropped from the package).**

[2] **If the non-recurring revenue from the sale of the Government's remaining shares in Teléfonos de México an 1 in commercial banks is factored in, then the public sector posted a surplus equivalent to 0.1% of GDP.**

hikes granted to government employees -together with an expansion of employment in the areas of education, health, justice and national security- drove up the level of payments for personal services to almost 10%. All these factors combined to increase real current expenditure despite a further decline in interest on the debt.

Capital expenditure by the federal government climbed 25% in real terms, mainly as a result of the increase in investment projects (29%) -most of which were executed by the National Solidarity Programme- and in communications and transportation projects. These expenditures had a fundamental impact in the first quarter and thus played an important role in reversing the recessionary trend in economic activity seen in 1993.

Overall, social spending expanded steadily (13% in real terms), with the main focus being on the development of the more backward communities. The bulk of these resources went for projects involving improvements in existing educational and health facilities and, to a lesser extent, the construction of urban infrastructure and rural electrification works.

The higher level of economic activity and the rate adjustments instituted during the year boosted the federal government's real income (2%), despite the various fiscal constraints to which it had agreed in late 1993 under the terms of the PECE agreement. Tax receipts were up 5% in real terms on 1993, even though income tax revenues shrank by 3% following the reduction of tax rates (from 35% to 34%) for corporations and self-employed individuals, the establishment of exemptions for workers earning up to two times the minimum wage, the granting of tax rebates to wage-earners in certain income brackets, and the reduction of the withholding tax on foreign interest income. Revenues from import duties also dropped (-6%) due to the tariff rollbacks made when the North American Free Trade Agreement entered into force.

Increases in other tax categories offset this decrease in receipts, however, VAT revenues were 10% higher in real terms than in 1993 thanks to the upsurge in both economic activity and imports, as well as the settlement of past debts of Petróleos Mexicanos (PEMEX). Revenue from the special tax on production and services increased by 35%, partly as a consequence of the decision to redistribute PEMEX'S tax burden between charges and taxes. As a result of this measure, non-tax revenues declined by over 3%.

In contrast, public-sectoi agencies and enterprises under direct budgetary control recorded a surplus, since their in comes increased slightly more than their expenditures in real terms. These organizations' spending levels rose in the areas of personal services, basic services, pensions and public works. This was also true of financial costs, which were up li'% from the year before. The expansion of physical investment by these organizations was much lower (1%), although PEMEX and Feder il Electricity Company (CFE) projects had a somewhat higher profile.

Most of the federal government's cash shortfall was financed with Banco de México credits. These operations took p] ace primarily in the last quarter. Indeed, up until the end of September, the credits granted to the federal government by the Banco de Mexico totalled some 7 billion pesos, but the figure jumped to 17 billion pesos during the fourth qi arter alone, thus generating a rise in liquidity which had the potential to put pressure on prices and the exchange rate.

In 1994 the Government added US$ 6.7 billion in short- and long-term obligations to its external debt, bringing the total debt to US$ 85.4 billion. Domestic borrowing by I he public sector amounted to 164.6 billion new pesos, which was 35% higher in nominal terms than the figure for 1993. The 31% increase in government securities was particularly noteworthy, especially since it entailed a change in the mix of financial instruments on the market, as the amount of *Tesobonos* issued increased twenty-four times over -with a high percentage of ti lese instruments being held by foreigners- whil<¡ the amount of *Cetes* outstanding was 49% lover than it had been at the end of 1993.

b) Monetary policy

In 1994 financial policy was influenced by a series of events which had a major effect on expectations. Serious incidei ts of political violence had a substantially negative impact. On the other hand, a positive note was struck in March with the announcement that standby assistance would be forthcoming from the United States and Canadian Governments (under the terms of the North American Financial Assistance Agreement), multilateral organizations and a number of foreign commercial banks at a time when financial and exchange-rate concerns were rife.

Acting within this framework and faced with a steep drop in international reserves, the monetary authorities proceeded to make substantial changes in their monetary and credit policies. For the past three years the authorities had systematically sought to dampen the growth of net domestic credit, and they had succeeded in lowering the annual rate of increase from 42% in 1990 to just 12% in 1993. In 1994, however, the credit supplied by the Banco de México to the banking system expanded by twice the amount of currency in circulation at the end of the preceding year; in addition, the amount of financing granted to other financial intermediaries almost doubled.

In April the country's financial authorities began to promote the purchase of *Tesobonos* -government paper redeemable at the prevailing rate of exchange upon maturity- in an effort to keep foreign investment in the money market and ease the pressure exerted on the exchange rate by volatile conditions in the economy. At the same time, a sharp rise in interest rates put a stop to the downward trend they had followed ever since late 1992. Thus, the nominal annual yield on 28-day *Cetes*, which had fallen to single-digit figures in the first quarter, remained at an average of around 15% throughout the rest of the year. Meanwhile, the average interbank interest rate doubled from an average of 11% in January-March to 22% in October-December. This increase, together with the slackening of inflation, drove up real interest rates. Yields on 28-day *Cetes* rose from an annual average of 3% in January-March to 11% in the second quarter before slipping back to 9% in the third and then to 8% in the last quarter of the year.

The considerable drop in liquidity resulting from the run-down of international reserves was more than offset by the expansion of domestic credit, and the amount of bills and coins in circulation climbed by 14% in real terms between December 1993 and December 1994; the real monetary base widened by a similar figure. However, the real demand for goods declined so notably that the money supply increased by a bare 1% in nominal terms. The lise in the real interest rate spurred the growth of time deposits, and the real expansion of the broadly-defined money supply (M2) was similar to that of the monetary base.

The expansion in bank credit to the private sector (an increase of one third in r eal terms) was much sharper and was largely based on the financing provided to commercial banks by the Banco de Mexico. Unlike what oc< urred in 1993, on this occasion a larger increase was observed in credit in the local currency ttan in foreign currency, though the latter still recorded real growth of 9%.

The combination of greater srivate-sector borrowing and high real interest rates led to a considerable rise in the ratio *o:'* commercial banks' overdue portfolios in 1994, The value of the banks' portfolios of overdue oans swelled from less than 30 billion new pesos in December 1993 to more than 48 billion rew pesos in December 1994; this increased the delinquency ratio (overdue portfolios as a percentage of total bank portfolios) from 7.2% to 8.3% and halved financial groups' liquidity and pofits for the same period.

The Mexican stock exchange experienced sharp swings. In March 1994 the steady rise in the Index of Prices and Quotations (IPYC) which had marked 1993 gave way to a period of sharp fluctuations, and the index finishec the year 9% below its initial level. As a conse< pence of the devaluation, returns -as measured in dollars- tumbled by 43% over the same period.

The December devaluation sparked an immediate reaction in financial markets, as evidenced by a brusque hike in hterest rates. Nominal yields on 28-day Ceies jumped from an average of 13% in October and November to 31% in late December. Similarly, the cost of money on the highly volatile secondary market soared, reaching rates of over 50%.

The steadily worsening ratio of reserves to short-term external maturities made it necessary to raise the yields on *Tesobonos* higher and higher, pushing these bonds' annualized yield to over 10% by the end of December. Despite this higher yield, the monetary authorities still found it difficult to place new issues, as wary investors took up only a small fraction of the paper on offer at the final two auctions of 1994 and the first auctions of 1995.

Outside Mexico, the lack of confidence drove down the prices of shares in Mexican firms (American Depository Receipts, or ADRs) traded on foreign stock exchanges by 40%; the price of par bonds (-25%) and discount bonds (-20%) being traded on secondary debt markets plunged as well.

c) **Foreign exchange policy**

For almost all of 1994, the exchange rate was allowed to float within a band whose ceiling was raised by four ten-thousandths of a new peso per day, equivalent to a depreciation of 4.6% per annum. In March, an increase in the going rate for the dollar began to be seen which, although not without some fluctuations, brought the currency very close to the band's ceiling. As a result, by the end of November the nominal depreciation of the interbank exchange rate had reached 11% with respect to the rate registered in December 1993.

The decision to raise the band's ceiling by an additional 15% in an effort to curb international reserve losses -without, however, coupling this move with any package of complementary initiatives- backfired when economic agents took it as a sign of the monetary authorities' growing inability to stem the outflow of foreign exchange. Thus, the view held by investors that the country's external imbalances were unsustainable made itself felt: the demand for foreign exchange immediately caused the dollar to shoot up to the band's ceiling rate of four pesos. Two days later, the Banco de México announced that it was withdrawing from the foreign exchange market. By the end of the year, the exchange rate had reached 5.2 pesos to the dollar, which was almost 50% higher than its pre-devaluation level. Foreign exchange pressures continued into the first months of 1995, with an average rate of 5.7 new pesos to the dollar in January, 5.8 in February and 6 9 in March. On some days, the new peso fell as low as 7.0 to the dollar, in a context of considerable volatility. By the end of the second quarter, th; exchange rate had rebounded to 6.3 pesos to th; dollar.

d) **Structurai reforms**

In 1994, Mexico continued to] >ush ahead with the adaptation of its institutional structure with a view to the country's integration into international markets, NAFTA entered into force as of 1 January, and in May Me> ico became the first Latin American member of the Organization for Economic Cooperation and Development (OECD). Negotiations on trade agreements were also concluded with a number of countries, including Costa Rica, Colombia and Venezuela.

On the domestic front, in April the central bank (Banco de México) was given autonomy as part of the governmental refont i process. With respect to the effort to modernize and liberalize the financial system, the formation of new types of financial intermediaries -sich as limited-liability finance companies- was authorized and rules were drawn up governing the opening of branch offices of foreign financial institutions. Within this framework, foreign b anks, insurance firms and leasing companies were given permission to set up operations ia Mexico.

In 1994, new rules for foreign investors came into force. These were contained in the Foreign Investment Act passed in the final days of 1993, which redefined the areas reseived for private Mexican citizens and the State, and those in which non-Mexicans would be allowed to participate. In addition, a number of regulatory provisions were modified as par; of the ongoing process of modernizing the laws governing relations between economic agents and their external links, some of which were derived from the implementation of NAFTA. In other noteworthy developments, customs laws were overhauled, regulations issued under the provisions of the laws on foreign trade were modified, the Consultative Committee on International Trade Practices vas established, new provisions on rules o: origin were introduced, Mexico acceded to the Patent Cooperation Treaty (Per), the Institute of

Metrology and Standardization was set up, legislation on public investment was enacted and the Mexican Institute of Intellectual Property was created. In the area of agricultural policy, a new mechanism for the provision of d rect assistance to producers (PROCAMPO) was introduced which took the place of the traditional sy¡ item of support prices.

3. The main variables

a) Economic activity

Following a lackluster performance in 1993 which extended into the first quarter of 1994, production activity picked up so briskly that the annual growth rate for 1994 as a whole verged on 3.5%. The most dynamic components of demand were investment -both public and private- and exports, with growth rates of 8% and 9%, respectively. The greatest contribution, however, was made by private consumption, which expanded by 4% and accounted for 80% of the increase in GDP.

The upswing in gross domestic investment boosted this variable to 22% of GDP. External saving once again played a very conspicuous role by providing 46% of the financing for capital formation (in 1980 dollars). The two components of investment -machinery and equipment, and construction- were very buoyant, the former especially so. It is interesting to note that private investment, in particular on the part of large corporations, continued to become increasingly dependant on external finance.

Exports of goods and services virtually doubled their real rate of growth; a substantial portion of this upswing was due to the boost in demand for manufactured goods generated by a stronger United States economy. The export boom led to an upturn in intra-industry trade and was heavily concentrated in certain industries within the manufacturing sector and in large corporations.

The gap between the expansion of total demand (6%) and GDP growth was covered by a sizeable increase in imports (15%). The performances of the various production sectors continued to be quite mixed. Basic services was the most buoyant activity, with both the transport, storage and communications and the electricity, gas and water sectors recording an 8% growth rate. Construction expanded by more than 6%, primarily as a result of the stimulus provided by government spending, although private-sector activity also helped to spur it or. The pace of growth began to gather quite a bit af speed in the second quarter owing to investments in petroleum and petrochemicals, transport and the construction of various types of facilities. Financial institutions, insurance *nd real estate expanded by 5% owing to the higher level of economic activity and the restructuring undertaken in the wake of the privítization drive. Other sectors, including mining, business services, restaurants and hotels, and agriculture, recorded growth rates below the overall average for the economy.

Preliminary data show that the production of 10 basic grains rose markedl\' during the spring-summer growing season in 1994. Output amounted to nearly 20 million tors, which was 13% more than the harvest for the (orresponding growing season in 1993. The bean, sorghum, wheat and rice harvests led thin increase in production. The livestock sector exhibited quite divergent trends: production of b< ef cattle and poultry was up sharply, while the c utput of eggs and honey was modest and mile production declined by more than 1%.

The manufacturing sector rebounded from 1993's slight decline to record an increase of 4%; this figure was the net result of the differing growth rates recorded by its vario is industries. On the one hand, the sound peiformance of export firms led to a marked rise in the output of metal products and machinery, which had slumped in 1993. The production of motor vehicles also showed particularly strong growth. This was due first and foremost to increased output of vehicles for export (up 17% on 1993), as production for the domestic market declined.

The basic metals industry also reported a substantial expansion (9%) after laving gone through a period of restructuring an 1 flat growth following the privatization of State enterprises.

Boosted by activity in the construction sector, production of non-metallic minerals rose by 4% with respect to the same period of 1993. Wood and wood products also staged a recovery following a succession of declines.

The constant retrofitting made necessary by the liberalization of trade resulted in a further downturn in the textiles and clothing and paper and printing categories. The above set of factors was also responsible for the lackluster performance of the food, beverages and tobacco industries. This situation was felt most keenly by small- and medium-size firms, which were also hurt by the rise in the cost of bank credit. The export-oriented *maquila* industry (i.e., inbond assembly activities) continued to expand at a rapid pace (8%) after having recorded a 6% growth rate the year before.

The financial crisis which occurred at the close of 1994, the steep devaluation and the adjustment measures adopted all combined to drag the economy into recession in early 1995. Accordingly, initial estimates pointed to a decline in GDP of around 1% for the first quarter.

b) **Prices, wages and employment**

The Government continued to place top priority on its anti-inflationary policy during 1994. Implementation of this policy continued to rest on the use of exchange policy as an anchor for price movements and on achieving a consensus among the various institutional sectors based on the PECE agreement signed in October 1993 and ratified in March 1994. The goal for 1994 of an inflation rate of 5% was also reaffirmed at that time. In order to meet that target, the authorities would have to maintain a balanced fiscal budget, restrain nominal wage hikes and persevere with the controlled float of the exchange rate within a progressively widening band.

Although the inflation target was not achieved, the rate of inflation did continue to move downward throughout 1994. With the entry into force of NAFTA, tariffs on many products imported from the United States or Canada were either reduced or eliminated entirely. This helped curb the rise in prices of domestically- produced import substitutes, thus narrowing many businesses' profit margins. This lessened the inflationary impact of the nominal devaluation of the currency in the first 11 months of the year.

The December-to-Decembcr variation in the national consumer price incex was, at 7%, the lowest in more than two decades but was still two percentage points above the Government's original target. The devaluation had a negligible effect on domestic price trends in 1994, since it took place just 10 days before the end of the year.

As in the preceding five yenrs, in 1994 the prices of tradables rose at a slower rate than the prices of non-tradables. Health and home care services and educational and recreation services reported some of the largest increases.

The producer price index (even excluding crude oil for export) rose by *9%,* thus doubling its 1993 level. The main reason for this was the robust increase (20%) in export prices prompted by rising international prices for the goods which Mexico exports and the depreciation of the exchange rate.

The open unemployment rati averaged 3.7% in 1994, up from the figure of 3.4% recorded in 1993. Other unemployment indicators revealed some improvement. The percentage of workers who were either unemployed or earning less than the minimum wage fell from *12A%* in 1993 to 11.3% in 1994, while the percentage of workers either unemployed or employed only part time -less than 35 hours a week- descended from 23% in 1993 to 22.2% in 1994.

Manufacturing continued to shed personnel, although at a slower rate than in 1993; these job reductions were seen in ill branches of industry. The 4.8% decrease in employment contrasted with the 3.6% jump in manufacturing output. The workforce in the *maquila* industry swelled by *8%,* and as a result the number of jobs directly generated by this sector passed the 600,000 mark

Real wages in the formal sector continued to regain ground in 1994. The average wages of workers employed in the manufacturing sector rose by 4% in real terms, and the figure for the *maquila* industry was quite similar.

c) **The external sector**

The first year of Mexico's participation in NAFTA was notable for a marked increase in merchandise trade. Total trade with the United States expanded by 22%, while total trade with Canada rose by 14%. Overall, imports grew at a faster pace than exports, leading to a considerable widening of the trade deficit, which was up 38% on 1993.

Trends in trade flows were similar to those of recent years. Exports of goods produced by the *maquila* industry rose by 20% in 1994, while other exports climbed by 15%; the corresponding figures for imports were 25% and 20%, respectively. The net result of the country's *maquila* operations was a surplus of US$ 5.8 billion.

The total value of merchandise exports (including the *maquila* industry) rose by 17% to US$ 60.833 billion; this achievement rested largely on the performance of non-petroleum exports, chiefly manufacturing. Sales of agricultural products were up by a modest 7%, largely as a result of higher sales of coffee, fresh fruits and vegetables, and pulses. Sales of other major products did not do so well; those of tomatoes, for instance, remained virtually unchanged, after having more than doubled in 1993, while sales of beef cattle decreased. Exports of petroleum products languished, since the modest increase in the average price of the mix of crudes that Mexico exports was offset by a slight drop in volumes and lower sales of petroleum products.

Among the country's exports of manufactures, industries having a high technological content made a particularly strong showing, as did, to a lesser extent, some of the industries producing intermediate goods and traditional finished consumer products. Specifically, sales in the metal products, machinery and equipment category rose by around US$ 7 billion, which brought them up to a level 25% above that of 1993. Within this category, the motor vehicle industry maintained its considerable momentum (21%), with particularly good sales figures for automobiles, trucks and engines. Impressive sales were also reported for information processors (up 50%) -thanks in large part to the *maquila* industry- and for machine parts and spare paits. Traditional industries which turned in outstanding results included the food, beverages and t jbacco and the textiles and clothing sectors; amor g intermediate goods, mention should be made of the upswing in sales of petrochemicals and chemicals, after a poor performance in 1993, and oí iron and steel products.

The very rapid growth rate of imports had abated somewhat in 1993, bit in 1994 it accelerated once again, as impoits climbed to US$ 79.375 billion -an increase of 21%- in response to both the economic recovery and the entry into effect of NAFTA. The three major categories of goods expanded at s milar rates.

Imports for the manufacturing sector were almost US$ 13 billion (21%) higher than in 1993, with 58% of the increase being concentrated in the metal products, machinery aid equipment categories. A particularly notable expansion was seen in purchases by the motor vehicle industry (22%), especially in the catégorie!! of passenger vehicles -which were more than double the 1993 figure- and engines and parts, tntra-industry integration with Mexico's leaJing trading partners was also reflected in a 30% upswing in purchases of information-processi lg machinery and parts, making 1994 the third coi îsecutive year of rapid growth.

During 1994 the authorities strengthened anti-dumping provisions in an effort to curb the use of unfair trading practices; accordingly, special countervailing quotas weie established for certain goods originating in Asian countries. Particularly strict quotas were imposed upon imports of footwear, clothing, tools and some intermediate chemical products, and these measures succeeded in dampening the rapid growth rates of these imports.

Non-factor services (excluding the *maquila* industry) posted a deficit of some US$ 2 billion; this was attributable to service: » other than tourism, since the tourism industry marked up a surplus. The deficit for factor services widened to US$ 12.2 billion (an 11% increase over 1993), primarily as a result of the upswing in foreign debt service caused by higher intt rest rates on international markets and the increased liabilities of the private ¡ ector and development banks.

The balance-of-payments capital account yielded a US$ 10.3 billion surplus. This was only one-third the size of the surplus recorded for the preceding year and fell far short of the amount required to finance the country's hefty current account deficit. Portfolio investment amounted to US$ 7.6 billion, a figure which stands in striking contrast to the US$ 28 billion registered in 1993. Foreign direct investment, on the other hand, continued its burgeoning growth, reaching a total of nearly US$ 8 billion (an increase of 63% on 1993). This growth trend was maintained throughout every quarter of the year.

International debt markets adopted a cautious attitude towards Mexican paper in 1994, thus compelling a number of national firms to put off the placement of debt instruments in those markets. Consequently, overseas borrowing by the private sector and banks increased much less than in 1993, whereas public-sector institutions and enterprises such as Banco Nacional de Comercio Exterior (BANCOMEXT), Nacional Financiera (NAFIN) and PEMIX continued to obtain external resources throjgh bond issues and other forms of borrowing.

The decrease in net international reserves in 1994 was on the order of US$ 19 billion. In the first two months of th; year, reserves climbed from US$ 25 billion to an all-time high of US$ 29 billion. In April, after the assassination of the presidential candidate, they fell by more than US$ 10.3 billion, and this loss was not recouped. From April until late October, reserves hovered around the US$ 17 billion mark; their level dipped by US$ 3 billion between mid-Juae and mid-July, but then quickly rebounded. Reserve losses amounted to US$ 3.7 billion in November and some US$ 1.5 billion in this first week of December; they then fell below the US$ 10 billion mark and continued to descend until reaching the critical levels which made it necessary for the Government to allow the exchange rate to float.

1. Gen trends

The Nicaraguan economy expanded by more than 3% in 1994, thereby marking up its highest growth rate in a decade. This creditable performance -which was primarily the result of a combination of internal political events, consistency in the management of the country's economy and the availability of external resources- was achieved against the backdrop of the challenges and obstacles posed by the complex transition that the country had embarked upon in 1990 as it moved from war to peace, from a single-party political system to a parliamentary democracy, and from a planned economy to a market economy.

Due to the country's dependence on inputs of foreign capital, these inflows continued to have a strong influence on the nature of the external sector's performance, the status of public-sector accounts, the exchange rate and the level of inflation. Larger inflows enabled the country to finance its deficit on current account, which swelled to over US$ 860 million, as well as a total public-sector deficit that climbed to 12% of gross domestic product (GDP). The nominal devaluation of the córdoba (10%) was smaller than the year before, and therefore inflation was also down (12%), since key prices in the economy remained linked to the exchange rate.

As the year began, a number of severe constraints continued to make their effects felt, especially in three areas. First, the external debt burden assumed during earlier administrations continued to weigh heavily upon the country. Second, the transition involved hefty one-time costs, such as those entailed in the assumption of a high level of domestic debt in order to help settle disputes over the ownership of land and the means of production. The Government has been covering this debt with wha: are called "compensation bonds", which th<; Ministry of Finance issues to persons whose property was confiscated and cannot be returned. Third, the relevant actors had not yet reached an acceptable consensus regarding the design of a new economic and political institutional structure for the country.

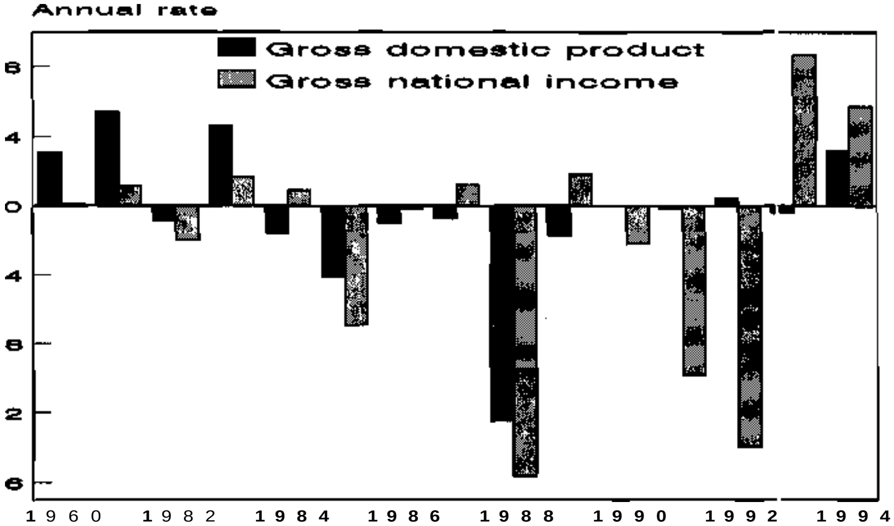
Early in the year, the Nicaraguan Parliament, which had been closed down, was « -opened, and this helped to clear the way for for;ign aid from the United States and facilitated negotiations with the International Monetarj Fund (IMF) concerning a structural adjustment loan. The enhanced structural adjustment fscility (ESAF) loan agreement signed in May 19i>4 brought in US$ 250 million from the IMF itself, as well as funds from other agencies. It also pived the way for another round of debt renegotialions with the Paris Club. A dispute arose, howe/er, between the Legislative and Executive branches over constitutional reforms, and the pri/atization of the Telecommunications and Pestai Bureau (TELCOR) was blocked.

The economy showed clear signs of buoyancy in the first half of the year, but this trend was interrupted by a drought which hurt what is known as the early harvest and mad< ; it necessary to ration energy supplies, thereby severely dampening economic activity. This situation was compounded by a transport strike smd financial problems in the State banking system.

Towards the end of the third quar er, however, the picture brightened thanks to a good late harvest, which was reflected in a ma ¡or upturn in basic grain output. In addition, higher coffee prices provided almost US$ IOC million in windfall profits.

Figure 1

NICARAGUA: MAIN ECONOMIC INDICATORS



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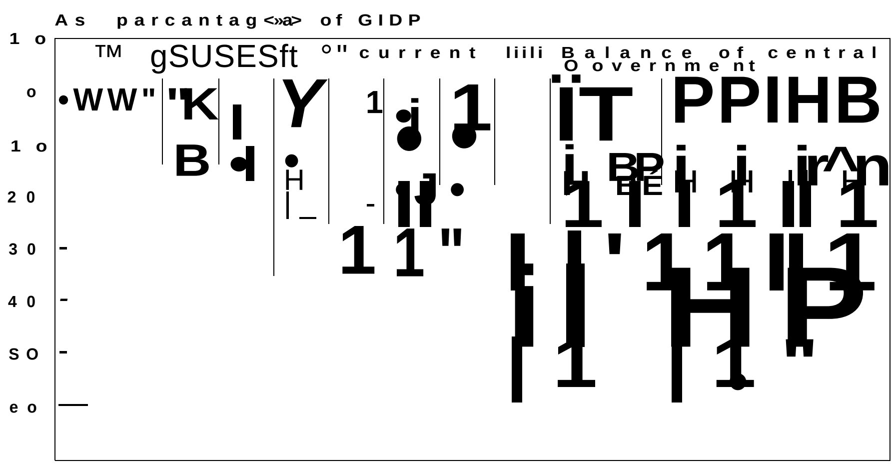

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2. Econ ic policy

Economic policy-makers had to cope with persistent macroeconomic imbalances in the external sector, in fiscal accounts, in the areas of saving and investment, and in the labour market. One of the most pressing problems of all was the disequilibrium of the external sector, since the value of imports was double that of exports and the interest due on the external debt exceeded the total value of exports. Under these circumstances, the economy needed a considerable injection of external capital in order to function and therefore had to go even more deeply into debt. The ESAF loan, and the economic policy commitments between the Government and the IMF which it entailed, thus exerted a decisive influence on the economic management of the country.

Once financing had been obtained to cover the external sector's deficit for 1994-1997, economic policy focused more on fiscal matters than on monetary variables. The Government's strategy revolved around the need to manage income and expenditure in such a way as to free up funds for investments in production activities that would promote exports and job creation in the medium and long terms.

a) Fiscal policy

The Government set itself the task of raising the public sector's current savings rate, and it therefore mounted an effort to boost current income and hold down current expenditure. As in the past, the level of investment expenditure was contingent upon the receipt of external financing.

The steps taken to increase revenues included a reduction in exemptions from import duties, the establishment of a broader tax base for the luxury tax and provisions regarding charges for public services and fines. In addition, gasoline prices were aligned with the currency's sliding parity, a strategic plan for increasing the effectiveness of tax collection procedures was carried forward, and a commission was established to combat smuggling. Other measures included a fiscal package known as Tax Reform 2000, which had been introduced prior to the signing of the ESAF loan agreement. Furthermore, as one consequence of the upswing in coffee prices, coffee growers became subject to income tax withholding provisions. In order to curb spending, a voluntary early retirement programme was set up for civil servants with a view to eliminating 7,000 government jobs in the course of 1994, civil service pay levels were frozen and cuts were made ir the Army's manning table.

Within the public sector as a whole, various mechanisms were introduced (e.g., the automatic deduction of interest payments on Central Bank discounts for commercial banks) Itiat succeeded in reducing the Central Bank's operating deficit. In addition, public institutions weie restructured as part of a programme designed to modernize the State, improvements were mad; in the public sector's financial management, and public services began to be decentralized

Despite these efforts, the Government proved unable to meet its fiscal targets because current expenditure roie more than current income did. The drought and the resulting energy crisis had a great deal to do with this, since they hurt tax revenues and saddled the National Electrical Power Institute with higher operating costs. According to the Government, another adverse factor was the poor resaonse to the labour mobility plan. The outcone of all this was that the central government's current deficit fell only marginally, remaining close to 1% of GDP, and the current saving rate for the public sector as a whole dropped to less than 3% of GDP.

Public investment increased from 8% to 11% of GDP. Capital income, however, was lower, since the privatizations carried out by the National People's Corporations (COdNAP), which is responsible for the administration and sale of 351 State enterprises, did not ¡;enerate any significant amount of liquid assets' even though the process was nearing completion. This was because the proceeds were primarily being used to cover the administrative costs of CORNAP and to withdraw approximately 250 million córdobas worth of compensation bonds from the

Table 1

NICARAGUA: MAIN ECONOMIC INDICATORS

	1987	1988	1989	1990	1991	1992	1993	1994[a]
				Growth rates				
Growth and investment								
Gross domestic product	-0.7	**-1.2.4**	**-1.7**	-	-0.2	0.4	-0.4	3.2
Per capita gross domestic product	-3.0	**-14.5**	**-4.3**	-3.0	-3.6	-3.4	-4.3	-0.7
Gross national income	1.3	**-15.6**	1.8	-2.2	-9.8	-14.0	8.7	5.7
Gross domestic product by sector								
Goods	-1.8	**-17.6**	2.6	-1.3	0.4	-0.3	1.0	6.7
Basic services	3.2	-12.1	**-0.3**	3.1	3.2	2.0	-2.0	0.9
Other services	0.1	**-5.9**	**-6.8**	1.0	-1.5	1.0	-1.8	-0.7
				Percentages				
Contribution to growth of GDP[c]								
Consumption	0.5	-5.2	-7.7	-4.4	7.8	-2.3	-6.6	1.0
Government	2.3	-18.8	-7.1	9.2	-12.4	-2.6	-0.7	-0.6
Private	-1.8	13.7	-0.6	-13.6	20.2	0.4	-5.9	1.6
Investment	-0.3	-6.5	-2.6	-2.2	1.9	-0.2	-1.6	1.7
Exports	0.3	-1.8	4.8	3.4	-3.4	3.7	1.0	1.3
Imports	-1.1	1.0	3.8	3.1	-6.5	-0.8	6.9	-0.8
				Percentages of GDP				
Gross domestic investment	22.1	17.8	15.5	13.3	15.2	14.9	13.3	14.6
National saving	-15.7	-27.9	-19.0	-16.5	-32.9	-41.4	-29.1	-25.1
External saving	37.8	45.7	34.4	29.8	48.1	56.3	42.4	39.7
				Percentages				
Employment and wages								
Activity rate	71.1	67.5	60.6	55.7	47.7	49.7	49.9	46.4
Open unemployment rate[e]	5.8	6.0	8.4	11.1	14.2	17.8	21.8	20.7
Real average wage (Index: 1990=100)		4.7	7.8	12.6	13.0	15.5	15.0	15.3
				Growth rates				
Prices (December to December)								
Consumer prices	1347.3	33 657.3	1689.1	13 490.3	865.6	3.5	19.5	12.4
External sector								
Terms of trade (Index: 1990=100)	102.9	100.2	111.9	100.0	96.7	68.3	74.9	82.3
Nominal exchange rate	70.00	0.27	15.66	689.96	4.27	5.00	6.12	6.72
Real effective exchange rate (Index: 1990=100)[g]		125.4	150.0	100.0	104.6	104.9	107.0	111.6
				Millions of dollars				
Balance of payments								
Current account	-814	-845	-531	-507	-849	-1095	-853	-863
Trade balance (goods and services)	-570	-583	-326	-290	-486	-610	-449	-428
Exports	325	273	341	392	338	309	367	445
Imports	895	856	667	682	824	919	816	873
Capital account	820	889	595	467	935	1095	774	932
International reserves (variation)	6	44	-190	-8	15	15	-93	68
				Percentages				
External debt								
Public debt (as a percentage of GDP)	227.1	474.1	929.5	677.5	648.1	574.2	610.4	657.4
Net interest (as a percentage of exports)	75.1	96.0	60.1	55.4	107.4	156.0	114.4	102.2

Table 1 (conclusion)

	1987	1988	1989	1990	1991	1992	1993	1994[a]
			Percentages of GDP					
Central government								
Current income	27.5	21.1	23.4	14.9	19.3	20.3	19.6	20.1
Current expenditure	39.4	41.3	26.7	30.7	23.5	22.1	20.6	20.9
Current saving	-11.9	-20.2	-3.3	-15.8	-4.2	-1.8	-1.0	-0.8
Capital expenditure (net)	4.7	6.4	3.4	1.3	3.3	5.8	6.3	8.9
Financial balance	-16.6	-26.6	-6.7	-17.1	-7.5	-7.6	-7.3	-9.7
			Growth rates					
Currency and credit								
Monetary balance of banking system								
Net international reserves					-43.1	0.6	-59.5	107.0
Net domestic credit			98.6	52.4	-38.5	442.3	-7.6	-2.5
To the public sector			98.1	59.5	-59.0	764.1	-10.9	-5.6
To the private sector		..	100.9	21.6	82.2	17.7	24.9	19.4
Money (Ml)			-2.9	-2.6	-1.5	12.5	-20.0	21.3
Savings and time deposits (in local currency)		..	195.7	-15.7	-6.0	35.2	24.5	75.2
M2					-2.5	17.1	-9.6	38.6
Dollar deposits		..	307.6	-17.3	-9.9	50.0	43.0	57.8
			Annual rates					
Real interest rates (end of period) [j]								
On deposits (savings accounts)	...	...	...	...	...	8.5	8.9	8.8
On loans (short-term)	...	...	...	...	...	19.7	20.1	20.3
Equivalent interest rate in foreign currency[k]				...	...	8.5	8.9	8.8

Source: ECLAC, on the basis of official figures.
* Preliminary figures. Based on 1980 dollars at constant prices. [c] These entries measure the impact of the variation in each aggregate on the variation in GDP. The coefficients were obtained by multiplying each aggregate's annu il growth rate by the level of that aggregate as a percentage of GDP. Percentages of the working-age population. [e] Ope i unemployment rate in Managua. This rate is expressed in córdobas per US$ 1,000 for the years up to 1987, in thousand i of córdobas per dollar for the years 1988-1990, and in gold córdobas per dollar for 1991 -1994, at the official exchange rate. [8] Based on the official exchange rate. No figure is given for 1987 due to the severe distortion of the exchange market d uring that year. Refers to net interest as shown on the balance of payments, divided by exports of goods and services. ' Interest rates are covered by a clause requiring the maintenance of dollar values; therefore, once the nominal interest rate has 1 «en adjusted on the basis of the real effective exchange rate, it is equal to the real interest rate. For these purposes, the Decc mber-December variation in this index should be used. [J] These figures represent a simple average of the floor and ceiling rates in the State and private banking systems. Interest rate on deposits, deflated by the variation in the exchange rate.

Table 2

NICARAGUA: MAIN QUARTERLY ECONOMIC INDICATORS

	1992				1993				IS 94[a]			
	I	II	III	IV	I	II	III	IV	I	II	III	IV
Consumer prices (12-month variation)	24.2	8.1	6.0	3.5	21.1	18.9	23.9	19.5	4.0	8.2	8.9	12.4
Real exchange rate (Index: 1990=100)	103.0	103.4	109.5	103.8	105.5	108.1	106.7	107.6	108.1	110.6	i 14.1	113.4

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures.

market and return them to the Ministry of Finance.

As a result, the fiscal deficit grew. The general government's deficit went up from 7% to nearly 10% of GDP while the public-sector deficit rose from less than 9% to 12%. This larger deficit was financed chiefly with external credit, which totalled 7.6% of GDP, versus 1.3% the preceding year. This increase in external borrowing made up for the downturn in external grants and donations, and also made it possible to reduce the public sector's domestic borrowing.

A considerable portion of such borrowing took the form of the issuance of compensation bonds to former owners of confiscated property. These bonds were payable in 15 years and accrued annual interest of between 3% and 5% which could be compounded during the first two years. Approximately US$ 200 million worth of these bonds were issued, which was half the amount estimated for settlement of all cases. The first interest payments -totalling an estimated US$ 6 million- were to fall due in 1995.

b) **Exchange policy**

Foreign exchange policy focused on maintaining the stability of the real exchange rate. To this end, the authorities instituted a crawling peg, with daily adjustments being made in the nominal rate in accordance with the guidelines laid down after the devaluation of January 1993. The targeted level for the official exchange rate called for a nominal devaluation of 12% over the year. Although the devaluation turned out to be slightly less (10%) than that, this did not affect the foreign-exchange market, since the spread between the official and parallel rates was only 3% as of December. The nominal devaluation represented no more than a slight real revaluation against the dollar, since other key prices in the economy were indexed to that currency. The real effective exchange rate did, however, increase once again.

c) **Monetary policy**

Under this system of regulated exchange rates, the monetary authorities took a "hands-off" approach to the increased level of liquidity in the economy. The expansion of international reserves resulting from the inf ow of external resources contributed to the growth of the monetary base. The money suoply (Ml) thus swelled by 21%, more than nominal GDP. Saving and time deposits, including deposits denominated in hard currencies, rose by more than 60%.

The economy's liquidity position was reflected in the fact that commercial banks maintained higher cash reserves than the minimum required by law. However, this overage in cash holdings, which had stood at 9% in 1993, fell to between 5% and 6% in 1994.

The rediscount rate remained linked to supply and demand, since in December L993 the Central Bank had decided to set the rate at quarterly intervals at 0.25% over the commercial bank interest rate on deposits. The rediscount rate exhibited a slight downward trend in 1994, falling somewhat less than one percentage point from the 11% level in effect at the beginning of the year.

The larger money supply pa ved the way for an expansion in private-sector credit of around 20%. In terms of the routing of credit, the emphasis clearly shifted from the official banking system to private banks. In fact, a programme financed by the United States Agency for International Development (USAID) was implemented in order to switch the State banking sector's portfolio ove: to the private banking system. Under this programme, the Central Bank purchased bonds (BOFOS) from private banks and these banks, which had traditionally focused on shor:-term business loans, were then to use the proceeds to finance long-term loans and the purchase of the State sector's portfolio. All the BOFOS for long-term loans were placed, but of the 140 million córdobas in BOFOS that were put on offer for portfolio purchases, only 35 million córdobas worth were actually traded.

As a counterpart to this programme to assist the private banking system, the Government decided not to recapitalize thi; State banking sector -the Banco Nacional de Desarrollo (BANADES), Banco Nicaragüense (BANIQ and Banco Popular- which was in the midst of a reorganization process. Any financing extended to this sector was not to exceed total loan recovery (i.e., zero net credit), which meant that any increase in the amount of credit to be granted would have to be backed up by an improvement in recovery rates.

The year 1994 became a milestone in Nicaragua's economic history when the Nicaraguan Stock Exchange opened its doors in January. Trading volumes increased gradually during the course of the year and in the early months of 1995. Securities traded on the Exchange included the Central Bank's foreign currency bonds (BOMEX), the compensation bonds issued by the Ministry of Finance, tax-credit certificates and debt paper from the Nicaraguan Sugar Estates, Ltd., a private company. The main purpose of the four bond issues floated by the Central Bank in 1994 was to help develop this market; the net balance at year's end was around US$ 13 million.

d) **Trade policy**

The country's trade liberalizai on policy was creating difficulties for some of he companies that helped to supply the domestic market, and a temporary selective tariff was therefore introduced on the understanding that it would be phased out later on. The liberalisation process proceeded, none the less, and negotiations were undertaken with a view to the contusion of free trade agreements with Mexico, «Iklombia and Venezuela. These talks were later suspended, however, because of the problems being experienced by Mexico and Venezuela.

Against a background of monetary and exchange-rate stability, measures were adopted to promote exports; these included a campaign to step up the country's use of the Caribbean Basin Initiative launched by the United States and the European Union's generalized system of preferences (GSP).

3. The main variables

a) **Economic activity**

Nicaragua's gross domestic product (GDP) rose by more than 3% in 1994; as a result, per capita GDP, which had been dropping sharply in recent years, remained more or less unchanged. National income grew by more than twice as much as GDP, thanks to the favourable trend in the country's real terms of trade.

The growth of GDP was associated with a partial recovery of the economy's level of aggregate demand (up 2%) from its steep decline of the preceding year. Both domestic and external demand played a part in this upturn. The fastest-growing component of domestic demand was investment in the construction sector, while the increase in private consumption was rather small. Because of the differing significance of these components, however, their contribution to GDP growth was quite similar. These two trends offset both the decline in investment in machinery and equipment that followed the preceding year's upswing and the contraction in government consumption resulting from its efforts to limit public spending.

Gross fixed investment slipped below 15% of GDP after having topped that level in 1993. This type of investment continuée to depend overwhelmingly on external siving for its financing, since national saving remained extremely negative.

The higher level of aggregate demand was met mainly by an expansion of do nestic output and, to a lesser extent, by a moderate increase in imports. The surge in economic ao ivity was not evenly distributed, however; insteal, differences were to be observed between oie economic sector and another as well as amor g enterprises in the same sector. In all sectors of he economy, firms still grappling with problems associated with the transition existed side by side with companies that had already solved t Kir legal and financial problems and had embarked upon a phase of rapid expansion.

The agricultural sector turned in an excellent performance overall and was thus able to move beyond the level of production it hid attained in the early 1980s. The increase in the output of basic grains was particularly noteworthy, especially in the cases of maize (25%), rice (33%) and kidney beans (37%). This trend was as much a result of the country's return to peace -since the land held by former combatants began to be farmed again, and conflicts and the level of insecurity in the countryside subsided- as of the rains which made for a good late harvest. The farm sector was also helped indirectly by the persistence of urban unemployment, since this prompted a migration from the city to the country.

Among the country's export crops, coffee output was up (28%) and the sugar-cane crop made solid progress (11%) as the process of transferring the mills over from State management to private enterprise proceeded, following two troubled years of labour disputes. By contrast, the banana harvest fell off sharply for the second year in a row and the downswing in cotton production worsened so much that the level of activity in this crop was negligible. Meanwhile, non-traditional export crops expanded at a smart pace.

Slackening activity in the livestock industry, which is one of the principal economic activities in the country, held its growth rate to just 3%. This slow-down was associated with lower meat prices and the consequent difficulties encountered by the industry's heavily-indebted producers in covering their commitments to BANADES. Poultry farming, however, kept up a good pace of growth (16%) and pig farming, which, among small-scale producers, is linked to the basic grain harvest, made a spectacular recovery (41%) from a slump that had lasted several years. The fishing sector's output continued its steady climb (36% in 1994), both for shellfish and the fishing catch itself.

Mining activity picked up (6%), thanks to the boost provided by the upturn in construction and to higher levels of silver and gold production. By contrast, manufacturing (1%) lagged behind the economic reactivation. The transition process was not yet complete in all businesses, as some firms still needed to formalize their adoption of new ownership structures and management practices. In addition, the operations of some enterprises had come to a standstill, particularly in the case of certain privatized firms or companies that were in the midst of a privatization process involving 1 heir purchase by workers. The fastest-growirg branches of industry were leather goods and footwear, household items and transport equipment, while the production of beverages and tobacco expanded in step with demand. On the other hand, the situation of manufaclurers of textiles and wearing apparel remained critical as a consequence, among other reasons, of steeply rising imports of used clothing.

Commerce and transport renained stagnant. The generation of electrical power ran into difficulties due to the drought, which drove down the output of hydroelectricity sharply (21%), after it had soared the year befe re. This made it necessary to step up the use of gas-powered turbines to generate electricity (whose production costs are higher), import electrical power and cut back on domestic consumption. Energy rationing mainly affecte i residential and government use rates (both of which sagged by nearly 10%), whereas industrial use rose.

b) **Prices, wages and employaient**

Inflation in 1994 amounted to 12%, which was generally in line with thi; Government's targets and the policy of maintaining a sliding parity for the currency. This pol icy turned out to be the chief determinant of the rate of price increases, given the growing tendency to peg key prices in the economy (including gasoline prices) to the exchange rate. This was no t done, however, with wages and other types of compensation, and real pay rates therefore weakened for the second year running despite the implementation of a wage hike early in 1994.

Despite the containment of real wages, the unevenly distributed increas; in economic activity did not permit any reduction to be made in the total under-utilization of the economically active population, an indicator which includes both unemployment and underemployment. To the contrary, the percentage of under-utilization climbed to a record high of :>4%. The open unemployment rate did edge downward slightly (although, in absolute terms, the actual number of unemployed persons rose), but this decrease was achieved at the cost of an increase in the number of underemployed persons. The higher level of underemployment was associated with the upswing in activity in the farm sector, which boosted the number of jobs in the production of both export crops and basic grains. The number of employed persons climbed not only in the primary sector but also in manufacturing (4%), construction (where it was bolstered by temporary employment programmes) and commerce.

c) **The external sector**

The external sector of the Nicaraguan economy continued to register an enormous gap between current payments and current income. This shortfall was covered with inputs of foreign capital.

The country's chronic trade deficit was eased by an improvement in its terms of trade, as a moderate rise in the unit value of imports was overshadowed by soaring price levels for some of Nicaragua's major exports, such as coffee and sugar. As a result, foreign exchange earnings from merchandise exports jumped nearly 30% in 1994.

Higher coffee prices and sales volumes once again made this product Nicaragua's number one export, followed by meat. The third-ranked category was non-traditional exports, which accounted for more than one third of total merchandise sales. The *maquila* (inbond assembly) industry expanded at a vigorous pace, with the Mercedes export processing zone (EPZ) trebling the value of its exports.

Imports (c.i.f.) gained nearly 6% in value. Particularly steep increases were seen in purchases of raw materials and intermediate goods (21%) and construction materials (39%), which is an indication that a fuller use was being made of the country's installed capacity. On the other hand, downturns in imports of capital goods (-8%) and in investment in machinery and equipment indicated that few projects to modernize or expand that capacity were being conducted. Imports of durable consumer goods rose considerably, but imports of the much larger category of non-durables were down.

As a result, the trade deficit narrowed by more than US$ 20 million, although it still outweighed the total value of merchandise exports. This improvement was more than offset, however, by a larger deficit in factor services, which was attributable to an increase in the amount of interest falling due on the external debt. Consequently, the deficit on current account widened to over US$ 860 million.

A change was to be observed in the mix of external resources which once aga n allowed the country to cover its current deficit and even to add US$ 68 million to its international reserves, inasmuch as the proportion of esternal credit mounted due both to the receipt of fresh loans (the main one being the IMF loan) and to the accumulation of almost US$ 240 million in interest arrears, while the sum cf grants and donations shrank to slightly over 40% of such financing.

The credit obtained by Nicaragua in 1994 helped to boost its external borrowings, thereby adding to its future debt service obligations, which were already so high that the i x)untry could not meet them fully. Thus, the debí mounted yet again, climbing from US$ 11 billion in 1993 to US$ 11.7 billion in 1994. The inteiest payments falling due on that debt continued o exceed the value of Nicaragua's exports o:' goods and services, although the ratio has been declining since 1992. In fact, the external debt was almost 27 times higher than those exports and over six times the size of the country's GDP.

Under the terms of agreements concluded in 1991 with the Governments of Germany and Italy within the framework of the Paris Club, US$ 308 million in debt was reregotiated in 1994. Nicaragua was also able to secure forgiveness for a smaller amount of t lebt from the Chinese Province of Taiwan. In March 1995, another agreement was reached w th the Paris Club for the forgiveness of two thirds of the country's debt with the Club, which amounted to US$ 1.6 billion. This agreement rray pave the way for renegotiations with other creditors.

Even if these arrangements were 1 inalized and the country's debt were cut to one third of its current level, its debt service oblige tions would still absorb the majority of its foreign-exchange earnings from exports. Consequently, in the medium term Nicaragua will have tc continue to rely on concessional loans.

PANAMA

1. General trends

The Panamanian economy marked up its fifth consecutive year of growth in 1994 against a backdrop of price stability. At a little over 4%, the economy's growth rate was lower than the high rates achieved in the preceding years, but even so it was enough to bring per capita GDP back up to the level it had reached prior to the 1988 crisis. Despite this strong performance, however, the open unemployment rate was verging on the disquieting level of 14%.

The recovery being made by the country's international banking centre continued apace. This increased the availability of credit, which in turn helped to boost consumption. Although investment continued to expand more rapidly than consumption, its growth rate slowed, partly because of the uncertainty generated by the run-up to the elections held in May and the change of administration which took place in September.

For the first time in many years, the country recorded a small trade deficit. Nevertheless, thanks to a reduction in external factor payments, it was able to cut the deficit on the balance-of-payments current account to US$ 100 million, which was easily covert d by the net balance of capital movements.

The central government's deficit grew slightly, but was still below 1% of GDP. Panama continued to service its debts witi multilateral and bilateral organizations after having regularized its payments situation in 1993, following an interruption lasting several years. It also rescheduled some of the bonds issued on its external debt and began to put its domestic debt profile in order. The renegotiation of the public sector's debt with private creditors remained pending, however. Any arrangement with the Paris Club would be continge it upon the definition of a structural reform programme, and such a programme was in fact in tie process of being approved by Congress durinj; the first half of 1995.

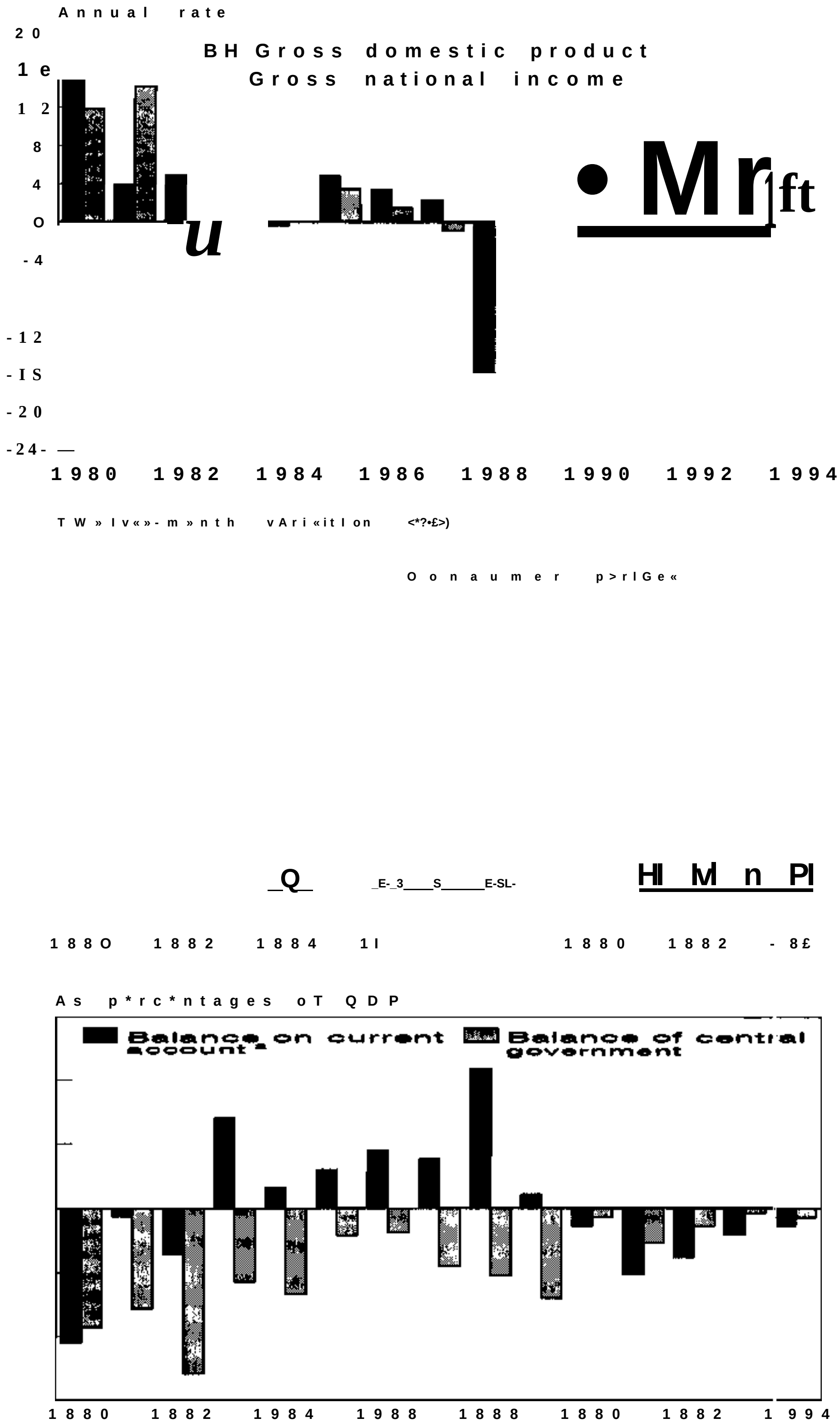
The new administration launched a series of initiatives in the areas of tax reform, tariff policy, debt renegotiations and the management of the resources located in the Canal ¡tone, whose gradual return to the country is to be completed by the year 2000.

2. Economic policy

The central government's budget performance -one of the main focuses of economic policy- was strongly influenced by the completion of the process undertaken in order to regularize Panama's payments on its domestic and external public debts and by the cautious approach it took to expenditures in view of the constraints affecting capital inflows and external finance.

The new administration's proposals revolved around a redefinition of the public sector's role and an expansion of the effort being made to open up the economy to external markets. Accordingly, initiatives were under aken on four main fronts: the negotiation of terms for Panama's accession to the General Agreement on Tariffs and Trade (GATT) with n the new institutional framework provided ty the World Trade Organization (WTO); reforms O the system of tax incentives and exemptions; the privatization of State enterprises, including the Instituto Nacional de Telecomjnicaciones

Figure 1
PANAMA: MAIN ECONOMIC INDICATORS



S o u r a o : ECLAC, on tina baala of official figuro.
• Of tina balança of paymanto.

(INTEL) and a portion of the Instituto de Recursos Hidráulicos y Electrificación (IRHE); and the institutional organization of the authority which is to manage the resources located in those areas of the Canal that have been returned to Panama.

a) **Fiscal policy**

The Government's fiscal policy for 1994 was geared to balancing the fiscal budget and moving forward with institutional reforms relating to the management of the public sector and the overall structure of the economy.

One of the main reforms to be proposed was aimed at providing comprehensive tax incentives for production, a step that would entail changes in the policy on government subsidies and exemptions for a number of economic sectors. In 1994 receipts amounting to nearly US$ 187 million balboas, or 14% of its annual current income, were forgone by the central government as a consequence of the exemptions from import duties and redeemable tax credit certificates which it granted. Nevertheless, the corresponding bill was still awaiting passage by Congress as of the second quarter of 1995.

Revenues were up slightly (by less than 4%). The increase in tax receipts (6%) was attributable both to the buoyancy of imports, which boosted the income from import duties by almost 8%, and to a strong domestic economy in 1994. The Government's non-tax revenues, which made up one third of total current income and were primarily derived from its share of the profits realized by State-run enterprises, failed to match their 1993 level, with the revenues provided by the State telecommunications company dropping by nearly 30 million balboas. Other non-tax income was up by almost 35 million balboas, however, thanks in part to the collection of fees for ship inspections, naval competency certificates and other such services for which charges had not previously been levied, as well as increased receipts from consular fees.

In order to eliminate the public debt overhang and put its financial situation in order, the Government paid off the debts, in cash, that it owed to the Social Security Fund and the National Bank of Panama. The Government had embarked upon this process in 1992 and at some points along the way found it necessary to resort to the use of postpaymer t mechanisms and debt instruments to cover its outstanding obligations.

The new administration strengthened the existing fiscal adjustment programme and carried forward only those projects that were already under way. Current savings, which totalled 125 million balboas for lhe year, were only enough to provide partial coverage for the execution of works in progress. Even so, the central government's accounts showed a deficit of 53 million balboas, most of which was financed with external resources.

One area of policy that carried a high priority for the new authorities was the piivatization of State enterprises, a process that had been initiated by the preceding administration. A lew approach was adopted under which, in addition to putting established firms on the auction block, infrastructure projects would be opened up for bids at the international level, as w is done in the case of the construction of the north-western and southern sections of the Pan American highway. The promotion of a system of private operating contracts and leases allowed the administration to combine a number of majoi objectives, including those of redefining the pi blic sector as a regulator of private-sector development and restructuring public expenditure so is to meet the need for social spending.

During the preceding administrai ion there had been a series of delays -die to legal circumstances or problems with the bidding process- which had caused foreigr investors to harbor some doubts about the process. Of a list of 20 firms that were up for privatization, the Government had been able to sell only nine, while another two were liquidated. In 1994 the State telecommunications company was converted into a semi-public enterprise due to a lack of sufficient fiscal resources ta pay for its modernization. Consideration was also being given to the partial privatization of tlie electricity company so that its production facilities could be modernized without the Government having to go into debt in order to finance the huge investments that would be required.

Table 1

PANAMA: MAIN ECONOMIC INDICATORS

	1987	1988	1989	1990	1991	1992	1993	1994'
	Growth rates							
Growth and investment								
Gross domestic product	2.2	-15.9	-0.2	5.2	9.2	8.4	5.6	4.3
Per capita gross domestic product	0.1	-17.6	-2.2	3.1	7.2	6.4	3.6	2.4
Gross national income	•1.0	-23.4	-2.2	9.8	14.3	13.7	5.5	3.6
Gross domestic product by sector								
Goods	4.6	-22.2	0.7	8.7	15.7	14.8	9.3	4.8
Basic services	4.7	-8.6	-4.9	0.8	10.6	6.7	3.2	6.1
Other services	0.3	-14.9	0.7	3.3	7.3	7.1	4.1	3.3
	Percentages							
Contribution to growth of GDP[c]								
Consumption	0.8	-16.9	9.3	-2.1	9.4	2.2	1.2	2.5
Government	1.1	-4.2	0.2	-1.7	0.3	0.4	0.3	0.8
Private	0.3	-12.8	9.0	-0.4	9.2	1.8	0.8	1.7
Gross domestic investment	0.5	-12.7	-3.8	15.5	2.2	8.2	6.4	2.2
Exports	•0.8	1.0	-1.7	3.8	3.9	3.4	1.5	3.6
Imports	1.8	12.8	-4.0	-12.0	-6.3	-5.4	-3.5	-4.0
	Percentages of GDP							
Gross domestic investment	20.0	8.6	**4.9**	**19.4**	19.8	25.8	30.5	31.4
National saving	22.3	18.8	7.6	17.6	19.6	28.3	31.0	30.9
External saving	**-2.3**	-10.2	**-2.7**	1.9	0.2	-2.5	-0.5	0.5
	Percentages							
Employment and wages								
Activity rate	57.7	56.9	58.9		57.5	60.2	60.5	60.6
Open unemployment rate[e]	11.8	16.3	16.3	16.8	16.0	14.7	13.2	13.8
Real minimum wage (Index: 1990=100[f]	100.9	100.5	100.7	100.0	98.9	97.4	108.8	107.3
	Growth rates							
Prices (December to December)								
Consumer prices	0.9	0.3	-0.2	0.8	1.1	1.6	0.9	1.4
External sector								
Terms of trade (Index: 1990=100)	104.0	86.6	89.2	100.0	103.7	109.1	106.2	101.3
	Millions of dollars							
Balance of payments								
Current account	205	500	49	-71	-283	-230	-136	-100
Trade balance (goods and services)	376	809	408	368	96	58	75	-14
Exports	3 840	3 624	3 795	4 537	5 468	6 397	6 707	7 309
Imports	3 464	2 816	3 387	4 169	5 372	6 338	6 631	7 323
Capital account	-242	-505		369	482	346	226	170
International reserves (variation)	-85	12	56	272	212	111	90	70
	Percentages							
External debt								
Public debt (as a percentage of GDP)	69.6	81.9	82.2	75.8	67.3	59.0	53.2	53.5
Net interest (as a percentage of exports)	1.1	6.3	8.4	8.1	5.5	**2.8**	**2.1**	0.5

Table 1 (conclusion)

	1987	1988	1989	1990	1991	1992	1993	1994[a]
				Percentages of GDP				
Central government								
Current income	20.3	13.1	12.2	18.5	19.6	21.0	20.1	19.7
Current expenditure	23.5	17.9	18.3	18.7	16.9	19.7	17.9	17.9
Saving	-3.2	-4.7	-6.1	-0.2	2.7	1.4	2.2	1.8
Capital expenditure	1.3	0.5	0.9	0.5	5.4	2.7	2.6	2.6
Financial balance	-4.5	-5.3	-7.0	-0.7	-2.7	-1.4	-0.4	-0.8
Domestic financing	13.1	5.7	7.0		0.1	1.7	-	-0.1
External financing	-8.5	-0.4	-		2.6	-0.3	0.4	0.9
				Annual rates				
Real interest rates (annualized)								
On deposits	7.1	9.0	10.8	9.1	7.1	4.4	5.5	6.2
On loans	10.9	12.7		12.1	11.5	9.1	10.5	9.6

Source: ECLAC, on the basis of official figures.
[1] Preliminary figures. [b] Based on 1980 dollars at constant prices. [c] These entries measure the impact of the variation in each aggregate on the variation in GDP. The coefficients were obtained by multiplying each aggregate's anm al growth rate by the level of that aggregate as a percentage of GDP. Percentages of the working-age population. [e] Percentages of the economically active population (EAP). Refers to the minimum wage in the manufacturing sector. [s] Reí ers to net interest as shown on the balance of payments, divided by exports of goods and services.

b) Other aspects of economic policy

The country's international banking centre continued to recover from the steep downturn experienced in 1988, thanks to a 26% increase in its assets and the addition of five more banks holding general and international charters. This enabled the centre to resume its position as a financial intermediary between the region's economies and the international market. The national banking system, which does not include banks holding international charters, was also able to make a sizeable increase in its assets owing to an expansion of time deposits by foreign banks and individuals.

This system-wide upswing in the level of bank assets opened the way for a 17% increase in credit to the private sector; the main beneficiaries were the manufacturing sector, the construction industry, personal consumption and especially commerce, which received two thirds of the total amount of credit extended. This sector's demand was generated by merchants and traders in the Colón Free Zone, whose level of ac tivity climbed considerably (11%) during the year. The annual interest rates on loans for commerce and industry averaged around 10%, which was somewhat lower than the rates charged on farm loans. Mortgage policies favoured loar applications from middle-income groups, while the Government raised the level of subsidies for multi-family housing units in the capital city.

The new administration steppe 3 up the pace of the negotiations concerning Panama's accession to GATT and, to that end, began to consider trade liberalization measures for a number of sectors. This sparked a heated debate within the country and mobilized the various sectors that would be affected by a comprehensive trade liberalization drive. During these negotiations the Government kept channels open for consultations with representatives of agricultural, industrial and commercial associations.

One of the country's major economic undertakings which has highly significant implications for the future is the administration of those areas of the Canal Zone that have reverted to Panama. In 1994 the Interoceanic Region Authority (ARi) was created and placed in charge of the management and development of these areas. This agency then proceeded to move forward with a number of projects for the development of these ureas's assets, including projects for the establishment of environmentalreserves,multisectoraleconomic zones, and cultural and educational centres, as well as other activities designed to provide services to meet international demand in the Zone.

3. **The main variables**

a) **Economic activity**

With an increase of over 4%, economic activity reached a record high, climbing to a point 15% above the level recorded prior to the 1988 crisis. This expansion enabled per capita GDP to regain its 1987 level.

The economy's performance was fueled by an acceleration of the growth rates for both public and private consumption and for exports, which were coupled with a slow-down in gross capital formation. However, even though the 6% rise in gross fixed investment was far below the spectacular rates registered during the economic recovery of the early 1990s, fixed investment still increased its share of GDP to 30%.

External demand strengthened markedly, paving the way for an increase of nearly 8% in export volumes; this rise was attributable to an upturn in re-exports, since exports of goods produced in Panama were down. Commerce in the Colón Free Zone continued to contribute to the economy's buoyancy as traders took advantage of the reactivation of South American markets within a more open economic environment.

Production sectors making an outstanding showing in 1994 included the banking system, commerce in the Colón Free Zone, construction and basic services. Less striking yet still positive performances were turned in by almost all the other sectors of the economy. The sole exception -due to the effect of austerity measures, which were further reinforced towards the end of the year- was government services.

The agricultural sector's rate of expansion was somewhat below the growth rate recorded for GDP as a whole. Among the country's export crops, the banana and coffee harvests showed an improvement (6% and 5%, respectively) as exporters strove to place these products in the international market. Banana producers were also helped by good weather conditions and the absence of any long-lasting labour conflicts. Soaring coffee prices between May and September spurred on the hai vesting of this crop, but yields were none the less limited by the inadequate maintenance of the country's coffee plantations. Efforts to open up new markets for Panamanian sugar failed to make headway, and output declined. The harvests of the main agricultural products sold on the domestic market registeied moderate increases.

The slaughtering of beef attle fell by 4% while pork production climbed slightly and the poultry industry improved its performance with an 8% increase in its output of chicken products and sausages. Activity in the lishery industry, which has been bolstered durirg the 1990s by stronger domestic and external demand and the investments made in processing facilities, was buoyed by the size of the shrimp catch and by a spectacular 75% jump in the praduction of fish oil.

An increase of almost 5% in manufacturing output represented a slow-down for the decade. Flagging demand for foodstuffs on the part of Central America was one of he reasons for the lower growth rate (2%) reported by this branch of industry, which is an extremely important one, since it provide;; more than half of the manufacturing sector's total output. A fire in the country's largest refi lery in the final quarter of the year reduced the output of petroleum products. The strong; showing made by the construction industry was a boon for producers of building materials and metal products, while the election campaign boosted activity in the paper and printing industry.

Even though it was one of the fastest-growing industries, construction still suffered its most severe slow-down thus far in the 1990s.

Services accounted for three fourths of GDP and continued to act as the engine driving forward the Panamanian economy's growth. The expansion of the transport sector stemmed from the country's intense commercial activity, especially in the Colón Free Zone, which was in turn linked to the favourable trends observed in world trade. Cargo shipments through the Canal were up by over 8%. The only decline in activity to be recorded was in the trans-isthmus oil pipeline, but even so the decrease was smaller than in earlier years, when it had borne the brunt of the effect of competition from the Alaskan pipeline. The production of electricity, gas and water responded to the heavier demand generated by private consumers and, in the case of electricity, by the public sector as well, where demand was stimulated by election-related activities.

Financial services, except those related to the ownership of residential units, did well in all categories. The number of tourists decreased as a consequence of the country's limited hotel capacity, but spending by tourists was up 7%.

b) **Prices, wages and employment**

The small increase in consumer prices -which rose at an annual rate of slightly over 1%- was a little higher than it had been the year before. Contributing factors in this very limited increase included rising oil prices and the need to import processed rather than crude oil because of the damage done to the refinery in the above-mentioned fire.

Wholesale price levels, which climbed by an annual rate of about 2%, were particularly affected by the increase registered for imported products (5%). Midway through the year, imported crude oil was costing almost 16% more than it had in December 1993, and its price rose another 11% during the second six months of 1994. Another factor was the higher price of imported motor vehicles, which, together with hydrocarbons, represent one fourth of the total weighting for the wholesale price index. Among nationally-produced goods, price hikes were recorded for vegetables, shellfish, sweets, some chemicals such as pesticides and petroleum products, beef and poultry.

No changes were made in official minimum wages in 1994. The increase in average civil-service wages was estimated at almost 5% above the growth rate in coniumer prices, however, and the total payroll climbed by nearly 2% despite a decrease in the number of civil servants. In Panama City's ba iking sector, average wages were over 3% higher in nominal terms.

The employment situation worsened, however, with some 9,200 persons being added to the ranks of the unemployed. The number of persons who were laid off and the number of unemployed among new entrants into the labour market both rose by between 7% and 8%, thus driving up the total unemployment rate to almost 14%. The deterioration in unemployment indexes was parti y a reflection of a reduced manpower absorption capacity in such activities as construction, manufacturing and tourism, which compounded the unemployment occasioned by the c ismantling of United States military bases located in the Canal Zone.

c) **The external sector**

Panama's current account showed a negative balance of US$ 100 million in 1994, The fact that this shortfall was less pronounced than the year before was attributable to the country's smaller deficit in factor services, since it ran up a US$ 14 million deficit in its trade in goods and services. Generally speaking, the country's external payments situation was a fairly comfortable one, while the amount of funds attracted by the international banking centre was oi i the rise and the national banking system found itself seeking out external markets for its capital.

The country's merchandise trale showed a deficit of over US$ 980 million, which slightly outweighed the nearly US$ 970 m ilion surplus yielded by its trade in real services. Commercial activity within the Colón Free Zone boomed, while both imports and exports of goods climbed nearly 11% above their 1993 levels in response to the opening of new markets in Brazil and Ecuador.

The level of merchandise imports which was cleared through customs was nearly four times as high as exports of domestically-produced goods.[1]

In an unusual development, imports of petroleum products in 1994 doubled due to the shutdown of the country's main refinery and stronger domestic demand from the transport sector. As in the two preceding years, one of the sharpest increases among the country's main import items was in private motor vehicles. This trend has helped to change the Panama's import mix, with motor vehicles and related equipment coming to represent almost one fourth of the total.

Imports by the Canal Commission shrank as facilities in the Canal Zone was gradually dismantled and support personnel were repatriated. On the other side of the coin, the establishment of temporary camps for Cuban refugees in the vicinity of the Canal, to be administered by United States military forces based in the area, boosted income.

Exports of Panamanian products remained sluggish as a consequence of the difficulties affecting the country's main traditional export products, such as bananas, sugar and, to a lesser extent, tobacco. Even so, bananas still represented nearly 40% of total domestically-produced exports, with shrimp taking second place. Exports of petroleum products also grew less than before due to the shutdown of the oil refinery and the curtailment of production in the final quarter. Non-traditional exports rose steeply, climbing to over 40% of the total. The most important and fastest-growing products in this category were medicines, pureed bananas, cowhides and shellfish preparations.

The most notable item among the country's exports of real services was transport services routed through the Canal, which, between tolls and other port charges, generated more than US$ 500 million. Greater trading activity on the part of South America and the Asian countries bordering the Pacific Ocean, along with the economic reactivation in the United States, resulted in a 4% increase in the net tonnage of freight carried through the Canal Meanwhile, net income from tourism was 13% higher than in 1993.

Net payments for factor sen ices plunged to just one third of their 1993 level as the increase in returns from Panamanian fore ign investments outpaced the growth of overseas interest payments and profit remittances.

The surplus on capital ace aunt was large enough to finance the current account deficit and to add US$ 70 million to the country's international reserves. Partly because of the conclusion of external aid programmes and partly as a result of the change it administration, the inflow of official and multilateral funds slackened in 1994. Consequently, this flow covered only one fifth of the service payments falling due on the public external debt.

The external debt owed to private creditors continued to mount (10%), rising to 63% of the total public debt, but external debt indicators exhibited no major changes from the year before. During the first half of 1994, an effort was made to bring the country's debt payments to official institutions and agencies up to date. This called for the rescheduling of US$ 465 million in overdue interest payments and, as part of this process, in May the country floated US$ 420 million in new paper on the primary market. To assist the Government in its effort to eliminate arrears with international financial institutions, the World Bank granted it a long-term US$ 120 million loan, only one half of which was disbursed.

No major movements were observed during the remainder of the year, except on the part of the Inter-American Development Bank, which pledged resources and disbursed funds for long-term projects aimed at leforming State enterprises. Late in the year, the reduction of the country's arrears paved the way for Panama to obtain fresh loans and to reactivate financial arrangements which had been suspended.

[1] **This does not include trading activity in the country's processing zones (EPZs).**

PARAGUAY

1. General trends

The Paraguayan economy's 3.5% growth rate for 1994 was somewhat lower than it had been in 1993 as a result of the fact that the boost given to the economy by the growth of private consumption was counteracted by the poor performance of Paraguay's main agricultural export products due to bad weather conditions and crop diseases.

The country's copious inflow of external capital, which enabled it to cover a deficit on the balance-of-payments current account equivalent to one tenth of total GDP, held the nominal exchange rate virtually steady throughout most of the year. This bolstered efforts to combat inflation by holding down costs, but the adjustment of public utility rates early in the year and an upturn in the components of external inflation that affect the country exerted pressure in the opposite direction. The net result, in an economy in which price formation is subject to widespread inertial mechanisris, was that inflation proved to be quite intracta ble. It was not until late in the year that some tieadway was made, when the 12-month variation in the consumer price index slipped to 18%, which was down *2%* from the figure for 1993. Further progress was made in the first lialf of 1995, however, with the annualized rate 1 ailing to 14% in May. Meanwhile, the public sector's surplus climbed to the equivalent of 3% ol GDP in 1994, thanks to a steep rise in tax receipts and in the proceeds from fees charged for the use of the Itaipú hydroelectric complex. This situation made it feasible to reduce the level of both external and domestic debt. The contraction of domestic credit offset most of the effect of the money creation generated by the re bust increase in Central Bank reserves.

2. Economic policy

In line with the strategy announced by the administration which had taken office in the second half of 1993, the top priority for economic policy-makers in 1994 was to lower inflation. A well-balanced management of fiscal variables and the setting of objectives for the growth of the money supply that were in keeping with a 15% target rate for inflation were the main tools used to this end; meanwhile, the country maintained its system of floating exchange rates, which allows for intervention by the Central Bank in currency markets.

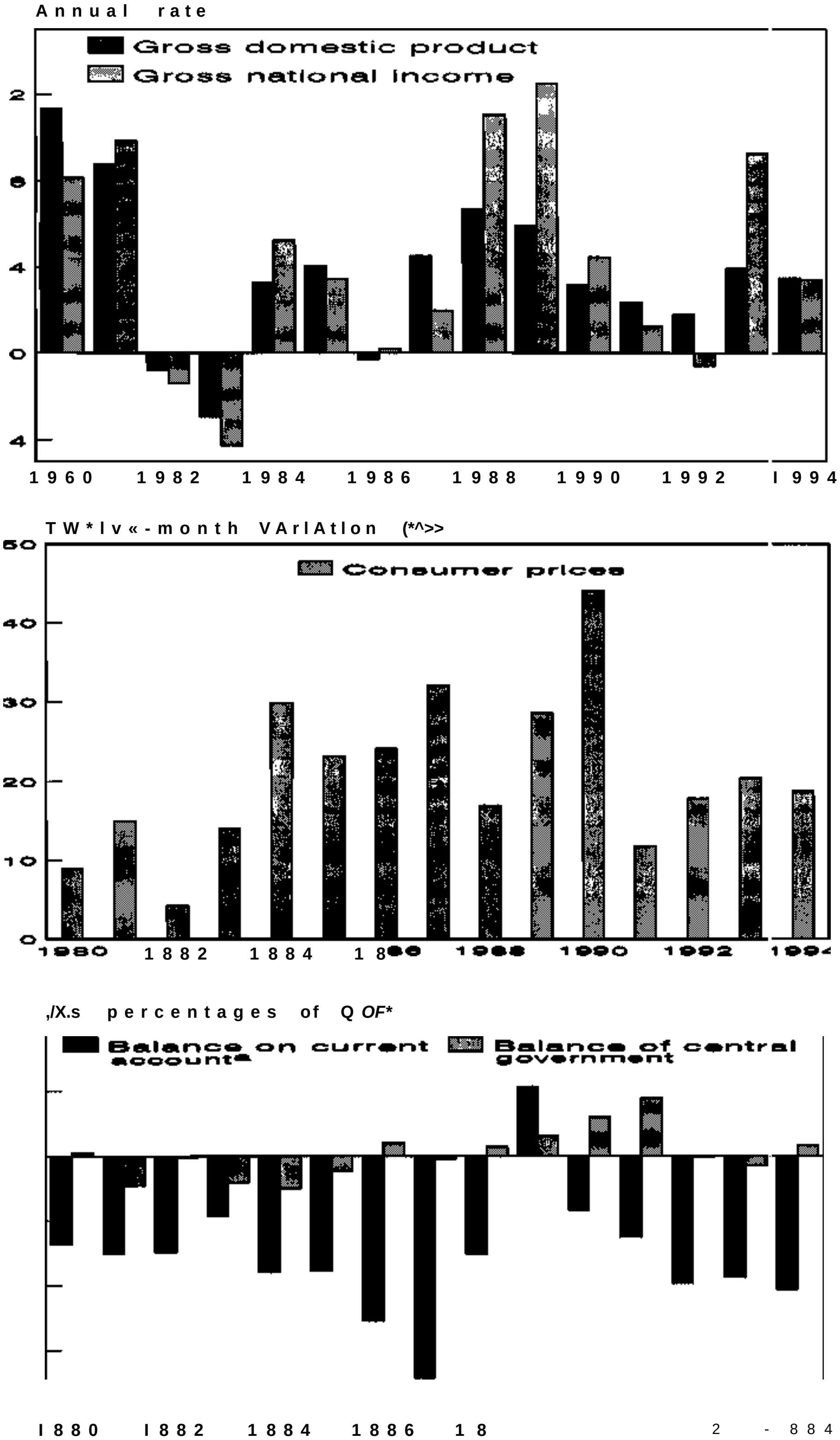
Towards the end of 1994 the process leading up to the country's official entry into the Southern Common Market (MERCOSUR) was completed. Through its membership in this regional group, Paraguay joined Argentina, Brazil and Uruguay in a limited customs union which entered into operation in January 1995.

Structural reform efforts made some inroads. In November, Congress passed a law that re-wrote the Central Bank's charte- and defined the structure of the Superintendency of Banks, but the Executive branch's veto effectively postponed financial reforms that had been in the pipeline. The privatization programme moved forward on a somewhat limited scale with the sale of LAP, the State airline, who ¡e name was changed to Líneas Aéreas Paraguayas, SA (LAPSA).

a) Fiscal policy

The effort to balance the country's fiscal accounts, which was one of the pillars of the

Figure 1
PARAGUAY: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.
[a] Of the balance of payments.

Government's stabilization policy, was facilitated by the tax reforms that had been implemented two years earlier. In fact, after both taxpayers and tax collectors had been allowed some time to adapt to the new system, the improvement of administrative procedures actually raised the central government's tax receipts by nearly 50%.

A striking increase (41%) was seen in the tax yield from domestic commercial activity. Within this category, the value-added tax (VAT) generated one third of the total, while excise tax receipts were up 31% and income tax revenues jumped by 71%. Receipts from taxes on foreign trade also rose considerably (41%) thanks to the boom in imports. In addition, fees paid by Brazil for the use of the Itaipu hydroelectric dam amounted to almost 3% of gross domestic product (GDP) and to nearly one fifth of the central government's total income. Consequently, even though expenditures climbed by 32% (a 16% increase in real terms), the bottom line on the central government's accounts switched from a deficit of nearly 1% of GDP to a surplus of about the same size.

Inasmuch as State enterprises managed to increase their net operating surplus as well, the public sector found itself in a quite comfortable financial situation, and this allowed it to cut back on domestic borrowing and thus buttress the efforts of monetary policy-makers.

b) **Exchange policy**

The system of a free-floating exchange rate coupled with Central Bank intervention in the currency market remained in place. The abundant inflow of external resources made it necessary for the Central Bank to trade heavily in the currency market in order to ward off a sharp appreciation of the local currency (the guaraní); in fact, the Central Bank was so active in that market that its net purchases from the financial system amounted to about 2.5% of GDP. This had such a strong stabilizing effect on the parity of the United States dollar that it rose only 5% in 1994.

Moreover, the steep rise in the value of Brazil's and the European countries' currencies against the dollar bolstered the guarani's competitiveness *vis-à-vis* the currencies of Paraguay's main trading partners n real terms.

c) **Monetary policy**

In 1994 monetary policy focus îd on soaking up the excess liquidity generated by the strong build-up in international reserves. ' rhis had led to a sharp increase in the amount of currency outside banks, thus undermining the stabilization policy, which had been designtd to prevent primary money creation from moving the economy away from its targeted ir flation rate.

The surplus posted by the public sector helped to rein in the level of liquidity by prompting the sector to cut back substantially on its net intake of credit, as was evidenced, in pi rticular, by a steep drop in borrowing from comr lercial banks. The management of the country's monetary affairs then focused on absorbing ***a*** cess liquidity through open-market operations, especially in the period between April and No/ember. This enabled the monetary authority to keep the monetary base under tight control, holding its rate of expansion to 27% for the y« ar.

In the place of the discount vindow made available to the agricultural sector, which was all but closed down in 1994, it was ajjreed that the financial system would increase ils lending to cotton growers and that, in exchange, the reserve requirement would be switched from non-interest-bearing reserves to Tr< asury bonds. This step not only reduced the finar ciai system's costs but also narrowed the spread between interest rates on deposits and loans,

Except for the first quarter, when inflation was higher than it was during the rest of the year, real interest rates on time deposits were positive, although they did tend to move dow nward. Even so, since the nominal exchange rate rose so slowly, local-currency deposits aïorded high yields in dollar terms. The reduction in the required level of non-interest-beaiing reserves from 25% to 18% and the slippage of rates on deposits led to a slight decrease in assets in nominal terms.

The downward trend in inflation and the stability of the exchange rate both h;lped to spur the demand for money. Accordingly, the money supply expanded by 31% in 1994. Furthermore,

Table 1

PARAGUAY: MAIN ECONOMIC INDICATORS

	1987	1988	1989	1990	1991	1992	1993	1994[a]
				Growth rates				
Growth and investment								
Gross domestic product	4.5	**6.7**	5.9	3.1	2.3	1.7	3.9	3.5
Per capita gross domestic product	1.2	**3.4**	2.7	0.1	-0.6	-1.1	1.1	0.7
Gross domestic product by sector	1.9	11.1	12.5	4.5	1.2	-0.6	9.3	3.4
Goods	5.4	**9.2**	6.6	2.0	0.3	0.7	4.2	2.2
Basic services	6.0	**7.2**	5.3	8.0	6.9	6.3	8.5	8.2
Other services	3.1	**3.4**	5.1	3.6	4.1	2.1	2.6	3.9
				Percentages				
Contribution to growth of GDP[c]								
Consumption	3.9	**2.9**	-0.4	12.8	2.6	5.6	9.7	5.7
Government	0.7	0.2	0.4	0.2	1.4	0.6	0.5	0.3
Private	3.2	**2.7**	-0.8	12.5	1.2	5.0	9.3	5.3
Gross domestic investment	1.4	**0.9**	2.2	2.1	2.0	-1.6	0.5	1.0
Exports	0.5	**5.9**	3.9	5.6	1.9	-1.1	9.8	1.4
Imports	-1.3	**-3.0**	0.2	-17.4	-4.2	-1.2	-16.2	-4.6
				Percentages of GDP				
Gross domestic investment	22.1	**21.6**	22.4	23.7	25.2	23.1	22.8	23.0
National saving	9.1	16.0	27.5	19.0	17.3	10.9	10.6	8.4
External saving	13.1	**5.6**	-5.1	4.7	7.9	12.3	12.2	14.6
				Percentages				
Employment and wages								
Activity rate	62.7	63.1	64.2	61.0	59.4			59.1
Open unemployment rate[e]	11.6	8.6	6.7	7.5	9.4	9.Í	9.0	9.0
Real minimum wage (Index: 1990=100)	85.6	102.9	104.2	100.0	95.4	87.1	83.7	86.0
				Growth rates				
Prices (December to December)								
Consumer prices	32.0	16.9	28.7	44.0	11.8	17.8	20.4	18.3
Wholesale prices	19.7	33.7	26.1	67.2	12.4		14.8	15.1
External sector								
Terms of trade (Index: 1990=100)	78.8	83.2	101.5	100.0	90.5	88.5	94.0	96.1
Nominal exchange rate (guaraníes per dollar)	800	928	1 145	1230	1 326	1500	1744	1912
Real effective exchange rate (Index: 1990=100)	93.1	96.5	101.9	100.0	86.9	90.6	92.2	97.4
				Millions of dollars				
Balance of payments								
Current account	-515	-243	234	-221	-392	-634	-644	-815
Trade balance (goods and services)	-406	-229	255	-214	-503	-678	-748	-857
Exports	770	1 102	1575	1880	1 887	1810	2 526	2 737
Imports	1 175	1331	1 319	2 093	2 390	2 488	3 275	3 595
Capital account	553	75	-88	440	691	287	731	1 142
International reserves (variation)	50	-173	109	220	299	-347	86	328
				Percentages				
External debt								
Gross debt (as a percentage of GDP)	68.0	62.3	45.9	32.2	26.7	19.8	18.2	16.7
Net interest (as a percentage of exports)	17.4	9.5	3.9	1.4	1.5	5.1	1.9	1.5

Table 1 (conclusion)

	1987	1988	1989	1990	1991	1992	1993	1994[a]
	Percentages of GDP							
Central government								
Current income	8.1	7.9	11.4	12.4	11.7	13.2	12.4	14.9
Current expenditure	6.5	5.9	8.9	7.0	5.8	11.2	11.3	11.7
Saving	1.6	2.0	2.5	4.6	5.0	2.0	1.1	3.2
Capital expenditure	1.8	1.3	1.0	1.6	1.5	2.1	1.8	2.4
Financial balance	-0.2	0.7	1.5	3.0	4.4	-0.1	-0.7	0.8
	Growth rates							
Currency and credit								
Monetary balance of banking system								
Net international reserves					46.3	-11.4	28.3	41.3
Net domestic credit					70.7	288.4	34.5	10.1
To the public sector							21.6	-58.4
To the private sector					59.6	39.2	35.7	36.7
Money (Ml)	37.8	25.7	46.1	27J	27.5	30.5	19.2	30.6
Savings and time deposits (in local currency)	...				29.4	41.8	18.7	49.5
M2	24.1	2o!<5	373	2o!o	35.3	35.1	18.9	38.7
Dollar deposits	13.0	8.3	892.2	63.1	56.0	66.5	53.0	15.3
	Annual rates							
Real interest rates (annualized) [8]								
On deposits				13.4	23.9	16.7	3.2	5.3
On loans				30.0	35.6	28.2	11.9	15.2
Equivalent interest rate in foreign currency				-18.3	-9.1	5.0	9.1	17.9

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Based on 1980 dollars at constant prices. [c] These entries measure the impact o[?] the variation in each aggregate on the variation in GDP. The coefficients were obtained by multiplying each aggregate's annus *I* growth rate by the level of that aggregate as a percentage of GDP. Percentages of the working-age population. Up to 19)1, these figures correspond to the metropolitan area; the 1994 figure refers to the entire country. [e] Percentages of the eco íomically active population (EAP). Refers to net interest as shown on the balance of payments, divided by exports of goo ds and services.
[e] For 1990-1992, the rates shown correspond to the month of December; the rates given for 1993 and 1994 are ¡nnual averages. Interest rate on deposits, deflated by the variation in the exchange rate.

Table 2

PARAGUAY: MAIN QUARTERLY INDICATORS

	1992				1993				1994[a]			
	i	**ii**	**in**	**iv**	**i**	**ii**	**in**	**iv**	**i**	**il**	**m**	**iv**
Consumer prices (nation-wide) (12-month variation, *%)*	12.0	14.8	16.7	17.8	18.0	18.6	16.6	20.4	22.4	20.9	20.9	18.3
Real bank exchange, rate, average selling rate (cash transactions) (Index: 1990=100)	87.6	90.1	92.4	92.2	90.8	93.4	93.0	91.4	89.9	91.5	101.6	106.5
Real interest rate (annualized, %)												
On deposits	...	2.7	6.3	16.7	-2.9	8.3	8.8	-1.3	-8.1	14.9	8.0	6.4
On loans	...	11.3	...	28.2	4.9	16.9	17.8	7.9	0.4	25.8	18.3	16.4

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures.

the spread between domestic and external interest rates boosted the increase in local-currency quasi-money, which jumped by a spectacular 50%. The increase in foreign-currency deposits was substantial (15%), but far lower than in the preceding years, and the broadly-defined money supply -which includes such assets- swelled by almost 30%. Consequently, the dollarization of the economy abated somewhat for the first time in many years. The expansion of the money supply enabled the banking system to increase its private-sector placements by 37% and thus to maintain the rapid growth rate registered the year before.

d) **Trade policy**

Paraguay completed the nece ssary procedures to join Argentina, Brazil and Uruguay as a member of MERCOSUR in 1994, As of 1 January 1995, a limited customs union entered into operation which granted the country 399 exceptions to the common external tariff; these exceptions will then be phased out over a 10-year period. Within *tie* domain of intra-community trade, Paraguay obtained exemptions up to the year 2001 for a total of 427 products.

3. **The main variables**

a) **Economic activity**

The sizeable drop in the cotton harvest -the country's main export- and the weak performance turned in by the manufacturing sector sapped the strength of GDP, which grew by less than 4%; as a result, per capita GDP increased by less than 1%.

The level of overall economic activity was hurt by the loss of momentum in goods-producing sectors, whose growth rate was only slightly more than one half (2%) of the 1993 rate. Total services, on the other hand, expanded by almost 5%, with their growth being driven primarily by basic services (8%).

Despite the poor performance of export crops, external sales -measured at constant values- expanded by 4%. Domestic demand, buttressed by a plentiful supply of external finance and an improvement in real wages, continued to climb at a smart pace (5%). Both consumption and investment (particularly purchases of machinery and equipment) showed a strong increase. The acceleration of investment raised its share of GDP to approximately 23%; in all, 37% of investment was financed with domestic funds and the remainder with external resources. Since the growth of total demand outpaced the increase in domestic activity, the physical volume of imports continued to rise steeply. It should be noted that a large share of merchandise imports are channeled into Paraguay's busy trade in re-exports to neighbouring countries.

The 10% drop in the cotton harvest -despite a 60% expansion in the amount of land under cultivation- had a strong impact on the economy as a whole and had adverse social effects in rural areas. Bad weather conditions and an onslaught of pests joined forces in damaging this crop, which is an extremely important one for Paraguay. In addition, the soybean harvest showed almost no growth despite an increase in the amount of land that was planted with this crop. The country's other crops, together with its livestock, fishery and forestry industries, exhibited moderate increases. The manufacturing sector remained s luggish, as it has been since 1990. Consequently, the increase of about 4% in construction activity turned out to be the most important engine of growth in the production of goods.

In contrast, the burgeoning growth of basic services continued, with the generation of electricity and the provision of water and sanitation services in the lead (13%).

[1] From 1993 on, the Central Bank of Paraguay includes an estimate of re-exports and of imports of th ; main categories of unregistered merchandise in its foreign trade statistics, thus invalidating any comparison between these figures and its foreign trade statistics for earlier years.

The remaining services followed the trend in overall economic activity quite closely.

b) **Prices and wages**

The authorities' strategy for stabilizing domestic prices was the cornerstone of their economic policy, and the main objective set forth by policy-makers was therefore to lower the annual rate of increase in consumer prices to 18% (it was 20% in 1993).

In 1994, the behaviour of the 12-month cumulative inflation rate went through two very different stages. Until August, this indicator defied efforts to bring it down, hovering at annual levels of 20%-22%. In the last four months of the year, however, the rate followed a definite downward trend, falling to its lowest point for the year -an annual rate of 18%- by December. This trend was closely related to the price and rate hikes which were instituted for public utilities during the first quarter and the adjustments made in the minimum wage in January and July. Indeed, a comparison of quarterly variations in consumer prices for 1993 and 1994 reveals that the first quarter was the only one in which the 1994 increase in consumer prices outdistanced the price rise recorded for the corresponding quarter in 1993. This indicates that, once corrections had been made in a number of public-sector prices (corrections which led to a one-time jump in the IPC), inflation began to fall into line with the course set for it by the administration's exchange, fiscal and monetary policies.

A particularly influential factor in the stabilization effort was the virtual immobility of the exchange rate for the dollar in the last three quarters of 1994, during which it increased by a scant 1%. Imported inflation -stemming mainly from the implementation of the Real Plan in Brazil- was one of the forces exerting pressure in the opposite direction.

Adjustments in the minimum wage brought nominal hikes of 15% in January and of 10% in July; this amounted to a gain of nearly 3% in real terms, following an uninterrupted deterioration in this wage level dating back to 1990. The general wage level for manual workers climbed by 1% in real terms.

The nation-wide unemployment rate held at around 9%. In Asunción, however, it slipped below the 5% mark, probably as a result of the greater buoyancy of predominantly urban service industries.

c) **The externa] sector**

Paraguay's trading activities include three distinct components. One is made up of the merchandise exports and imports associated with domestic economic activity. Another is the large volume of imported items which Paraguay sells to its two large neighbours, Argentha and Brazil. In view of the magnitude of this trading activity -for which few statistical records {re available- since 1993 trade statistics have included an estimate of the flows moving in both directions. The third component corresponds to the binational hydroelectric complexes at Itaipu, on the Brazilian border, and at Yacyretá, on the Argentine frontier, which generate a considerable inflow of foreign exchange in the form of royalties.

Paraguay's balance of payments showed a sizeable increase in its deficit on cuirent account; this gap was easily covered with lhe country's copious inflows of external resources, two thirds of which were entered under the hea ling of errors and omissions. This inflow was equivalent to 15% of GOP and made a substantia 1 addition to the country's net international reseives, causing them to swell to over 4% of GDP.

The extremely high figure fo: errors and omissions raises serious questions as to that entry's content, with the central qtestion being whether it corresponds mainly tc inflows of private short-term capital or primarily to current-account transactions, which would mean that the trade deficit was actually considerably smaller. Trans-border transactions for 1994 were estimated to total around US$ 80) million in unregistered imports and re-exports in both directions (43% and 97% of the corresponding registered trade flows). The size of this figure suggests than an appreciable percentage of the errors and omissions entry represents unregistered trading activity.

Registered imports climbed by or e third, with the increase being attributable to the steep upturn in imports of capital goods and to the strength of domestic demand within the context of a stable exchange rate. Exports of Paraguayan goods also displayed a good deal of momentum (9%) despite the decline in exports of cotton and soybeans -two of the country's main products- since the decreases in these items were offset by increased exports of other products and higher cotton and soybean prices on the international market. The binational hydroelectric complexes were a significant source of foreign exchange, providing an inflow of US$ 500 million, which was 25% above the figure for the preceding year. Nevertheless, the current account of the balance of payments did show a deficit, but it was easily covered by the country's hefty inflow of both long- and short-term external resources. In the case of long-term assets, the upward trend in direct investment -which amounted to nearly 2.5% of GDP in 1994- vas a notable development. Inflows of short-term capital were also quite heavy, as was attested to by the Central Bank's constant presence in the j oreign exchange market as it sought to stave off an unwanted revaluation of the guaraní.

Registered exports exhibited a high degree of concentration, with a full two thirds of such sales going to Brazil and the Netherlands (37% and 27%, respectively). Meanwhile, one half of Paraguay's imports came from MERCOSUR.

The external public debt edge d up to US$ 1.27 billion, the equivalent of one sixth of GDP. This debt is fairly evenly divided between international agencies and the Paris Club.

PERU

1. **Gen trends**

Overall, 1994 marked the second year of the Peruvian economy's recovery -this time at a rate of nearly 13%- from the prolonged recession, political unrest and social crisis which had plagued the country since the mid-1980s. Even so, gross domestic product (GDP) was still 10% below its 1987 level, and the cumulative gain achieved over the last two years was equivalent to scarcely one third of the amount of per capita income lost during the preceding period.

The expansion of the economy was brought about by an across-the-board increase in total demand amounting to over 10% of GDP, much of which was covered with external resources. Private consumption generated a great deal of the momentum behind this increase, with a contribution to GDP of 8%. It was followed by investment (with a 6% contribution), which skyrocketed by 36%, while exports accounted for another 3% of the expansion. For the second year in a row an increase (to a full two thirds) was registered in the percentage of investment that was financed with national savings, which rose by over 2 percentage points from the preceding year's level to nearly 17% of GDP in 1994.

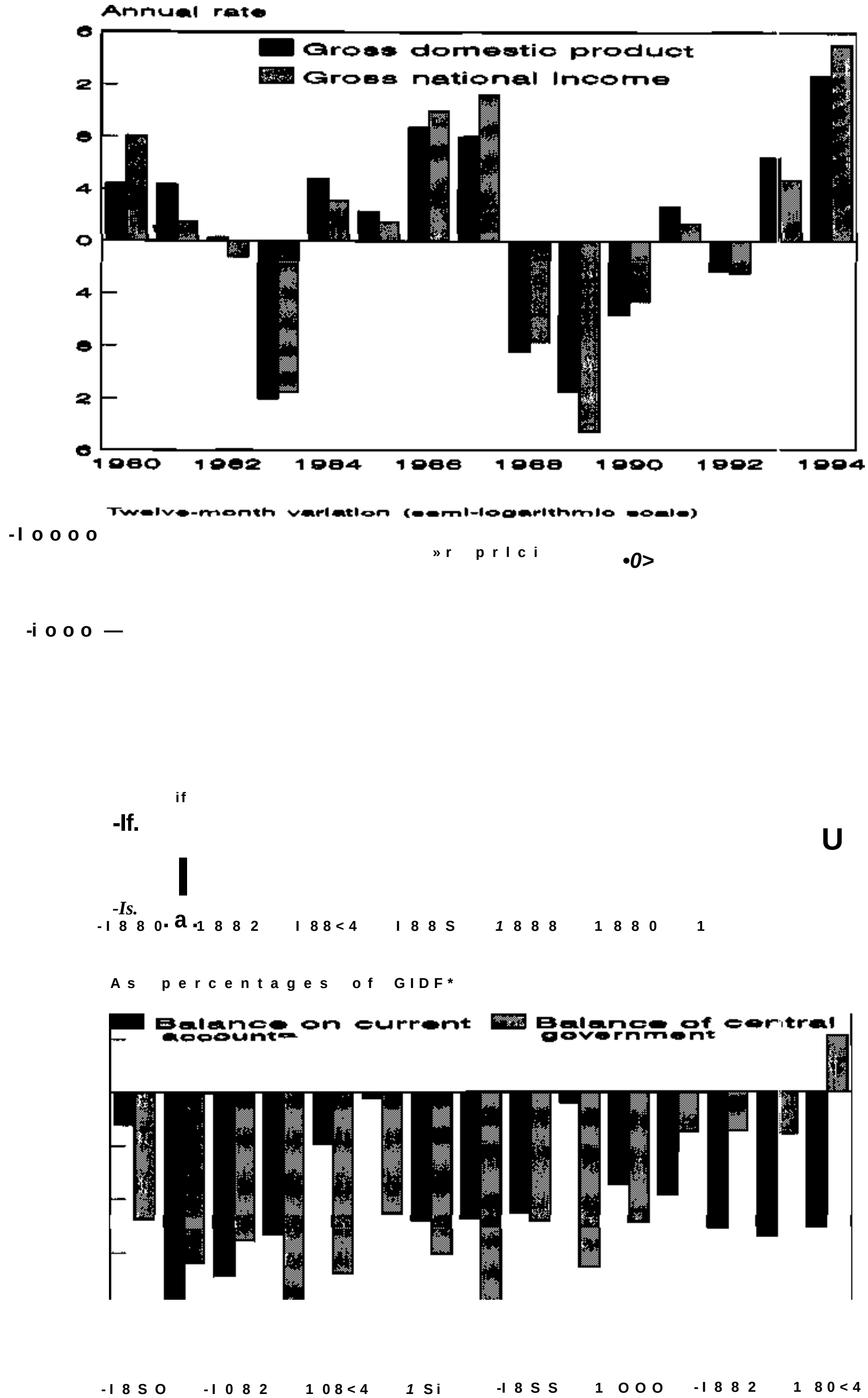
Under the stabilization programme in effect since mid-1990 -which has brought thorough-going economic reforms, including financial and trade liberalization, new legislation on foreign investment and the privatization of major State enterprises- inflation slowed to an annual rate of 15%. This was less than one half the 1993 level and the lowest to be recorded in the last 15 years.

This achievement was made possible by a combination of factors, including the stability of the nominal exchange rate, an ample supply of imports (thanks to the steps taken to open up the economy to external markets and to Peru's low tariffs), a decline in agricultural prices in response to plentiful harvests, and greater confidence on the part of economic agents, which gave rise to a rapid remoneti/.ation of the economy. The performance of tht public sector helped to move the economy in the same direction, since although fiscal policy was expansionary, it did not impact prices due to the availability of external resources, a large portion of which took the form of proceeds from privatizations. In a departure from earlier years, the non-financial public sector'! current and capital expenditures both rose by inore than one point of GDP, but the ratio of fisci .1 expenditure was still a moderate 15% of GDP.

Domestic production responded with alacrity to the upsurge in demand, but a considerable portion of consumption was none the less covered with imports. The deficit on the balance-of-payments current account widened to over US$ 2.7 billion, which brought it close to 6% of GDP. Although exports, meai.ured in terms of value, jumped by nearly 30%, hus breaking free of the flat growth curve observed over the preceding three years, the merci tandise trade balance continued, as it has for the p ast five years, to move more deeply into the red, w ith the deficit doubling to over US$ 1.1 billion. Nevertheless, the inflow of external resources -including approximately US$ 5.8 billion from privatizations- provided so much more than was needed to cover the deficit on curent account that international reserves swelled by over US$ 3.1 billion (nearly 6% of GDP) .

The upswing in the level of economic activity had little effect on the labour markt t. Household surveys conducted in Lima and data gathered on establishments employing moie than 100 workers indicate that open unemployment fell by less than one point; employment levels in manufacturing and commerce were down, but

Figure 1
PERU: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures this decrease was offset by a 4% rise in employment in the services sector. A sizeable portion of the slight improvement seen in the labour situation was attributable to an increased absorption of manpower by smaller business enterprises, which in Peru tend to be in low-productivity segments of the economy.

During the first quarter of 1995 the economy continued to flourish, registering a growth rate of around 10%, while inflation continued to subside, with the annualized rate as of April standing at 11%. Mexico's economic crisis did not seem to have any major impact on Peru's external sector. Net international leserves, which had reached an all-time record of US$ 5.8 billion at the close of 1994, were drawn ilown by about US$ 200 million in order to defniy some of the costs of the armed conflict that broke out with the neighbouring country of Ecuador.

President Alberto Fujimori's re-election by a large majority in April was well received by the business community and foreign investors, who felt that it would assure the coitinuity of the country's existing economic strategy.

2. **Economic policy**

As in 1993, Peru's economic policy for 1994 sought -successfully so, as it turned out- to combine an economic recovery with a reduction in inflation. The strong upturn in the level of economic activity was bolstered by an expansionary fiscal policy, which was financed with the revenues supplied by a considerable increase in the tax burden and by the privatization of public assets. Another mainstay was the steep increase in private expenditure which took place against the backdrop of a steadily expanding supply of both domestic and external credit. An improvement in the supply of agricultural products also contributed to this trend.

The abatement of inflation was fostered by an intensive remonetization of the economy as economic agents' favourable expectations fueled a substantial increase in the demand for real money balances. The virtual stability of the going rate for the dollar in a foreign exchange market having an ample supply of hard currency at its disposal -which made imported items less expensive- and abundant harvests -which drove down the farm sector's prices even in nominal terms- also helped to dampen inflation.

a) **Fiscal policy**

Fiscal policy followed an expansionary line, with emphasis on investment, thus paving the way for an acceleration of the gradual return to the levels of public participation which had evaporated during the country's bouts with hyperinflation in the second half of the 1980s. This recovery has been based on a revival of economic activity, progress in the stabilization of prices and an abundant supplj of external finance, combined with the preseivation -at all costs- of a strict financial balance in public-sector accounts.

The non-financial public sec or yielded a primary surplus (excluding interés payments on the external debt), even if the proceeds from privatizations are not counted. The sector's overall financial balance also boasted a surplus, which amounted to 1.6% of GDP if privatizations are not included and to 2.5% of GEP if they are.

This performance was made possible by a 23% increase in tax revenues in real terms, which climbed from 9.3% to 10.5% of GDP, chiefly as a result of the boost provided by the general sales tax. The higher rate of tax collection was attributable to the economic reactivation and to the reform and modernization process pursued by the National Tax Administra ion Superintendency (SUNAT). This programme, which is being carried forward with financ; al assistance from IDB, focuses on streamlining the system, broadening the tax base and curtailing tax evasion. At year's end arrangements were also concluded with IDB for a US$ 1.5 million loan for the modernization of the National Customs Superintendency with a view to inproving the collection of taxes on foreign trade,

An increase equivalent to nearly one point of GDP brought the central government's level of current expenditure to nearly 10.7% of that variable, while gross capital expenditure amounted to about 4.4%, or almost two points higher than in 1993. Public investment,

Table 1

PERU: MAIN ECONOMIC INDICATORS

	1987	1988	1989	1990	1991	1992	1993	1994[a]
	Growth rates							
Growth and investment								
Gross domestic product	**8.0**	**-8.4**	-11.5	-5.6	2.6	-2.3	6.5	12.7
Per capita gross domestic product	**5.8**	-10.2	-13.2	-7.5	0.6	-4.1	4.4	10.6
Gross national income	11.2	**-7.7**	-14.6	-4.6	1.4	-2.5	4.7	15.0
Gross domestic product by sector								
Goods	**7.4**	**-7.2**	-10.3	-5.6	3.5	-3.5	8.4	16.5
Basic services	**9.7**	**-4.7**	-8.3	-4.6	2.3	1.1	5.3	7.0
Other services	**7.7**	**-9.8**	-11.8	-5.8	2.4	-1.9	3.8	8.9
	Percentages							
Contribution to growth of GDP '								
Consumption	6.9	**-6.8**	-12.1	-2.9	1.1	0.9	1.9	8.8
Government	**0.6**	**-1.7**	-0.7	-1.0	0.2	0.3	0.4	0.9
Private	6.2	**-5.1**	-11.4	-1.9	0.9	0.6	1.5	7.9
Gross domestic investment	**5.2**	**-2.1**	-7.1	2.4	2.3	-1.5	2.6	6.4
Exports	**-1.6**	**-1.7**	3.6	-3.8	1.9	0.4	1.8	3.5
Imports	**-2.5**	2.1	4.1	-1.4	-2.7	-2.0	0.2	-6.0
	Percentages of GDP[b]							
Gross domestic investment	22.1	21.9	16.7	20.2	21.9	20.9	22.0	25.2
National saving	**15.0**	**15.9**	16.1	15.7	15.4	12.6	14.0	16.6
External saving	**7.1**	**5.9**	0.6	4.5	6.5	8.3	8.0	8.6
	Percentages							
Employment and wages								
Activity rate	61.2		61.2	61.3	57.2	58.8	60.8	60.8
Open unemployment rate[e]	4.8	7.1	7.9	8.3	5.9	9.4	9.9	8.8
Real average wage (Index: 1990=100)	278.6	210.1	114.5	100.0	115.2	111.1	105.7	121.4
	Growth rates							
Prices (December to December)								
Consumer prices	114.5	1 722.3	2 775.8	7 649.6	139.2	56.7	39.5	15.4
Wholesale prices	72.4	1 877.1	1917.9	6 534.0	96.0	50.5	34.1	10.5
External sector								
Terms of trade (Index: 1990=100)	100.7	110.2	94.4	100.0	94.2	91.3	83.7	92.6
Nominal exchange rate (new soles per dollar)	0.02	0.16	3.48	0.19	0.76	1.25	1.99	2.20
Real effective exchange rate (Index: 1990=100)	189.8	195.8	122.1	100.0	82.1	80.9	89.1	84.6
	Millions of dollars							
Balance of payments								
Current account	1820	-1457	-141	-1 116	-1649	-2 143	-2 217	-2 734
Trade balance	-943	-475	783	-75	-617	-1233	-1236	-1723
Exports	3 592	3 686	4 379	4 076	4 207	4 331	4 355	5 639
Imports	4 535	4 161	3 596	4 151	4 824	5 564	5 591	7 362
Capital account	1 172	1468	735	1402	2 536	2711	2 662	5 852
International reserves	-836	55	613	225	413	594	447	3 118
	Percentages							
External debt								
Gross debt (as a percentage of GDP)	39.7	51.1	52.4	61.9	48.1	50.8	53.8	46.1
Net interest (as a percentage of exports)[g]	23.2	25.6	20.7	25.3	23.7	19.7	21.1	16.6

Table 1 (conclusion)

	1987	1988	1989	1990	1991	1992	1993	1994[a]
	Percentages of GDP							
Central government								
Current income	9.6	8.8	7.1	8.4	9.2	11.0	10.8	12.4
Current expenditure	15.2	12.2	11.5	12.0	9.2	10.0	9.8	10.7
Saving	-5.6	-3.4	-4.4	-3.6	0.0	1.0	1.0	1.7
Capital expenditure (net)	2.4	1.4	2.1	1.3	1.4	2.4	2.6	3.8
Financial balance	-8.0	-4.8	-6.5	-4.9	-1.4	-1.4	-1.6	2.1
Non-financial public sector								
Financial balance					-1.5	-1.4	-1.2	2.5
Domestic financing					-0.7	0.5	-0.3	1.1
External financing					2.2	0.9	1.5	-3.6
	Growth rates							
Currency and credit								
Monetary balance of banking system								
Net international reserves	-90.7	-493.0	-272.0	24.8	183.6	25.5	20.6	106.6
Net domestic credit	152.2	766.3	1456.7	-96.0	177.4	53.7	89.1	-18.8
To the public sector	417.2	267.3	1932.3	-94.5	-118.6	-1 133.0	-90.5	-626.9
To the private sector	100.9	500.9	1 860.2	-94.4	284.8	96.4	81.6	62.0
Money (M1)	137.0	491.5	1 805.7	-95.3	124.6	71.3	46.5	60.6
Savings and time deposits (in local currency)	82.5	359.2	4 061.9	-97.7	273.0	46.9	52.1	88.7
M2	115.3	440.3	2 400.4	-96.4	164.4	60.5	48.4	73.7
Dollar deposits	-19.7	47.1	33.5	6.7	140.6	17.2	43.6	33.4
	Annual rates							
Real interest rates (annualized)								
On deposits		...	-47.2	-54.3	13.7	1.9	3.4	6.0
On loans		...	-31.2	-13.0	248.2	55.8	41.2	32.8
Equivalent interest rate in foreign currency			85.0	-33.8	57.5	8.6	9.3	24.8

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. Based on 1980 dollars at constant prices. [c] These entries measure the impact ol the variation in each aggregate on the variation in GDP. The coefficients were obtained by multiplying each agreggate's annus 1 growth rate by the level of that aggregate as a percentage of GDP. Percentages of the working-age population. [e] P xentages of the economically active population (EAP). For 1987 and 1988, the exchange rate is expressed in new soles per I tiousand dollars. [8] Refers to net interest as shown on the balance of payments, divided by exports of goods and services. [h] Interest rate on deposits, deflated by the variation in the exchange rate.

Table 2

PERU: MAIN QUARTERLY INDICATORS

	1992				1993				1994[a]			
	I	II	III	IV	I	II	III	IV	I	II	III	IV
Gross doemstic product (Index: 1990=100)[b]	97.7	103.3	98.2	102.4	98.3	109.5	109.3	110.7	109.1	126.9	120.9	126.2
Consumer prices (12-month variation, %)	100.8	78.4	57.7	56.7	51.3	49.9	47.0	39.5	31.5	24.1	19.3	15.3
Real effective exchange rate (Index: 1990=100)	73.8	75.5	83.9	90.5	87.6	90.5	89.7	88.4	84.2	83.3	86.5	84.3
Real interest rate (annualized, %)												
On deposits	-6.3	4.5	10.1	-0.6	-5.5	1.4	8.7	9.2	3.8	9.2	5.1	5.9
On loans	48.5	57.8	71.5	45.5	37.1	39.0	44.2	44.3	36.0	38.1	28.5	28.8
Money (M1)[c] (12-month variation, %)	113.0	73.5	80.3	79.1	87.2	63.9	60.4	54.7	50.4	66.2	70.1	61.8

Source: ECLAC, on the basis of official figures.
' Preliminary figures. Based on values computed at constant prices in the country; these figures have not jeen seasonally adjusted. [c] Quarterly averages.

buttressed by privatizations and external credit, was concentrated in infrastructure projects and social spending, especially on the construction of medical clinics and schools.

b) **Monetary and exchange policy**

Faced with a heavy inflow of external resources, in 1994 the Central Reserve Bank of Peru played an active role in the foreign exchange market -within the framework provided by the country's system of floating exchange rates- in order to prevent the nominal exchange rate from backsliding. Thus, following a slight gain in the third quarter, the price of the dollar declined during the final months of the year, falling back to virtually the same level as at the close of 1993. This led to a further deterioration -of around 5%- in the real effective exchange rate.

Inasmuch as the public sector did not draw on Central Bank credit, since it was in a surplus position, the increase in the money supply stemmed from the sizeable build-up in international reserves. During the first half of the year, the monetary effect of this expansion in reserves was sterilized by deposits in the Central Bank made by the public sector and the Banco de la Nación. Consequently, the increase in money creation for the 12-month period ending in June totalled about 30%, as compared to an annual rate of inflation of around 24% for the same period. During the second half of the year, the momentum of domestic demand and the sharp slow-down in prices sparked favourable expectations and strengthened the public's preference for real money balances. At that point the monetary authority relaxed its policy stance, particularly as it related to public-sector deposits, which caused the money supply's rate of expansion to pick up speed. Hence, despite the steep decrease in inflation, the annual growth rate for the money supply hovered around 60% throughout most of the year, leading to an intensive remonetization of the economy, with Ml approaching the equivalent of 4% of GDP.

This remonetization process extended to local-currency quasi-money, which soared by 89% and boosted the broadly-defined money supply (M2) by almost 74%. Although foreign-currency deposits griiw less quickly (33%), the economy's degree of dollarization remained very high, with foreign-currency deposits making up two thirds of the financial system's total liquidity.

The interest rate on local-currency loans moved downward throughout the year, descending from a nominal annual rate of 72% in the first quarter to 40% in the last. In real terms, however, it remained above ar annual level of 28%, with the spread between it and the rate on deposits holding at over 20%. Dollar-denominated interest rates fell less sharply, from 16.4% to 15.6% between the beginning and end of the year, with a spread of 8% over the deposit rate; this differential was partly attributable to the policy governing minimum rese rve requirements for foreign-currency deposits, which accrued interest at IÍBOR plus commiiision. Since the foreign-currency rate was substantially lower than the local-currency one, business firms continued to borrow in dollars (150% of the credit extended by the banking; system was denominated in foreign currency), thereby assuming the attendant exchange risk.

c) **Trade policy**

Under the terms of a trade integration agreement signed in 1992, Venezuela and Peru agreed to extend their tariff preferences to include another 198 Venezuelan products and 89 Peruvian ones; 60% of these trade preferences are reciprocal and chiefly concern items produced by the textile ind agricultural sectors.

When the international price!; of commodities that are staples in the Peruvian population's diet dropped below their pre-established floor levels, the authorities proceeded to levy duties on imports of rice, maize, whole milk and wheat.

d) **Structural reforms**

In 1994 the country continued to pursue its structural reform programme, whose central component is the privatization of State-run enterprises, and in the process look in a total of US$ 2.1 billion. The largest-scale operation of this type took place in the first quarter, with the sale of the Peruvian telephone company (COPERTEL) and the national telecommunications firm (ENTEL). Other major privatizations of companies in the fields of energy, mining and fisheries included the sale of Tintaya (copper mining), the Cajamarquilla zinc refinery, Edelnor and Edelsur (electrical power distributors) and Cementos Lima.

In addition, in November a "citizens' equity" system entered into operation under which Peruvians were given the opportunity to acquire stock in State-owned firms.

As part of the reforms being introduced in the financial system, in December the Banking and Insurance Superintendency authorized the operation of Small Business and Microenterprise Development Units (EDPYMES) in order to provide financing to this sector.

Difficulties stemming from tiw privatization of the social security system madî it necessary for several administrative boards to merge. The number of persons signing up for social security coverage was lower than expected, and this has been attributed to the. fact that the cost to the employee is higher than it was under the previous system, since, in addition to the basic contribution (10% of the employee's wage), enrollees mist pay for a "solidarity bond" (1%) and life insurance (4%). Nor did the Government's delay in paying on claims transferred from the old system, the scarcity of investment instruments or the shortcomings of the correspond» g regulatory structure do anything to encourage people to join the new system or to further its development.

3. **The main variables**

a) **Economic activity**

All sectors of economic activity were buoyed by the country's political and social stability, the high level of confidence among economic agents, the inflow of external resources and generally good weather conditions in 1994, but the sectors which took the fullest advantage of these favourable conditions were construction, fisheries, agriculture and manufacturing. Unlike the situation in earlier years, the reactivation of the manufacturing sector, whose growth rate approached 18%, was fueled by the processing of primary products; this branch of industry's momentum then spread to the rest of the sector, and its other components consequently posted considerable increases as well (16% for consumer goods, 18% for intermediate products and 15% for capital goods).

The boom in construction (34%) was due to the ambitious road-resurfacing projects undertaken by the public sector with the help of funding from IDB, the World Bank and the Andean Development Corporation. The National Housing Fund also financed large-scale projects dealing with water distribution and sewerage networks, electrification and the construction of multi-family housing units. Private residential construction for middle- and high-income sectors also rebounded thanks to the fact that more financing was made available through the use of mortgage bonds.

The vitality of the fishery sector (31%) was associated with the anchoveta catch, which was helped by the presence of large schools of fish along the coast. This, along with Norwegian, Danish and Chilean investments aimed at modernizing the fleet, upgrading ewsting plants and building new ones, allowed Pen to maintain its position as the world's leading source of fishmeal. Strikingly high growth ra es were also recorded for tinned fish (89%) and frozen fish (77%).

Thanks to good weather conditio is, there was enough water to expand the amounl of farmland under cultivation and increase tlie output of potatoes (17%), rice (44%), sugar *(.16%),* coffee (6%) and cotton (71%) as well as of wheat, maize and whole milk, which enjoyed the protection afforded by import duties when prices on the international market slippec below a pre-determined floor price. The combination of these two factors led to a 13% expansion of the agricultural sector.

The privatization of State-owned mining companies moved ahead, and some new projects began to yield promising results. The amount of iron ore mined by the Shougang-HierroPerú consortium outdistanced the 1993 figure by 34%, while its output of gold jumped 29%. The maturation of large investments in gold and copper mines and in oil production activities are expected to galvanize the sector in the near future.

In sum, with an increase of 17%, the production of goods was the fastest-growing sector. Basic services exhibited a below-average growth rate (7%), although electricity, gas and water services did climb by 12%. Transport and communications activity was up by a smaller amount (6%), while the remaining services (which include commerce) rose by 9%.

b) **Prices, wages and employment**

The consumer price index reflected a steady decline throughout 1994 in the rate of price increases, which averaged 1.8% per month, for a yearly rate of slightly over 15%. The slow-down was steeper for tradables, as the nominal exchange rate held steady, and less so for non-tradables due to the fact that public utility rates were raised, especially in the cases of electrical power and telephone services.

In a departure from the trend seen in earlier years, the labour force received substantial wage hikes; one contributing factor in this regard was surely the 30% increase made in the minimum living wage. A survey of establishments having more than nine employees in the Lima metropolitan area found that pay levels were up by 20% for white-collar workers and by 15% for blue-collar jobs.

The buoyancy of the economy had no major impact on employment levels. A survey of establishments employing over 100 workers in the Lima metropolitan area found that employment in 1994 was down by 1% in manufacturing and by 8% in commerce, with these decreases being just barely offset by a 4% increase in the services sector. These figures point to strong gains in productivity in the modern segments of the economy together with a proliferation of own-account work.

c) **The external sector**

The deficit on the balance-of-payments current account amounted to over US$ 2.7 billion, with a little over US$ 1.1 billion of that sum being accounted for by the merchandise trade balance. A slightly smaller sum -which includes the financial costs of i npaid service on the public debts refinanced wilh the Paris Club and with a private external supplier (JAPECoy- corresponded to payments for financial services. The balance -roughly US$ **615** million- was attributable to non-financial services.

The sizeable increase in the value of imports triggered by the country's faster pace of economic activity, a higher rate of investment and the stability of the United States dollar all played a part in widening the trade deficit by nearly 40%.

The total value of merchandise imports bordered on US$ 5.6 billion, which was 39% more than the year before. The categories at the forefront of this expansion were consumer and capital goods.

Merchandise exports mounted to the record level of US$ 4.5 billion -30% above the 1993 figure. This outcome was primarily a reflection of the increase in traditional exports (35%) -especially in products from the mining (33%), crop-farming (214%) and fishery (30%) sectors- although external sales of non-traditional products did rise by 19%. Estimates prepared by the Central Reserve Bank attribute the jump in traditional exports to a 13% increase in their physical volume (with fishineal making a particularly significant contribution in this respect) and a 17% rise in prices. This made for a 12% upturn, with the terms-of-trade index for goods returning to its 1991 level. Some of the commodities that posted the largest increases were coffee, copper, gold, lead and zinc.

The capital account registered an inflow of almost US$ 5.9 billion; almost IIS$ 2.4 billion of this sum was in the form of direct investments made in connection with the privatization of ENTEL and COPERTEL and some US$ 470 million in portfolio investment. Capital movements associated with international organizations yielded a net inflow of about US$ 820 million, while another US$ 470 million came from unrequited transfers. The remainder -a little more than US$ 1.7 billion- was made up of short-term inflows. Thus, ono; the deficit on current account has been subtracted from the above, the figures show that net international reserves climbed by slightly over US$ 3.1 billion in 1994.

Arrangements were made during the year for US$ 1.2 billion in fresh credit, 90% of which was granted by international agencies for terms of over 12 years. On the other side of the coin, the country paid out nearly US$ 2 billion in amortization and service payments, bringing the external debt to US$ 23.4 billion. In the first quarter a bilateral debt restructuring agreement with the Export Development Corporation of Canada was approved and the Swiss Government's decision to forgive US$ 133 million in debt was finalized.

Action taken in connection with the private external debt included the resumption of negotiations with international banks in the third quarter, after the Peruvian Parliament had confirmed the legality of debts incurred in 1983 with Chemical Bank and American Express. Once the total sum of debt arrears had been determined (it was estimated at US$ 8 billion), the Government was planning to seek a Brady-style agreemenl in the course of 1995.

Finally, regulations were established permitting the use of public ;xternal debt paper in the privatization of Stale enterprises. These regulations stipulated that the Commission for the Promotion of Private Investment (COPRi) would set the prices at which the relevant acquisitions were to be made.

DOMINICAN REPUBLIC

1. General trends

The uncertainty generated by the Dominican Republic's upcoming elections was a factor of overriding importance during the first eight months of the year; it contributed to a deterioration in fiscal and external accounts, helped to fuel expectations of a devaluation as well as inflationary pressures, and played a part in the erosion of international reserves. In September, after the elections, the authorities began to implement new fiscal, monetary and exchange policies which led to an improvement in the economic picture: aggregate demand contracted, the exchange rate stabilized in banking and non-bank markets, and international reserves made a partial recovery.

Against this backdrop, the country's gross domestic product (GDP) did better than the year before, marking up a growth rate of over 4%. On the demand side, this expansion was associated with faster growth in merchandise exports and public expenditure. On the supply side, it was attributable to an upswing in the mining sector and an increase in the value added by construction and commerce.

On the down side, inflation jumped from just 3% in 1993 to 14% in 1994. A widening fiscal gap -as the central government, after having broken even or posting surpluses on its financial accounts for a number of years, ran up a deficit of over 1% of GDP- and an increase in the use of bank credit to help cover that ¡hortfall were important contributing factors in the ascent of domestic prices. In turn, the loss of confidence in the local currency, along with the resulting acceleration of the rate of devaluation, boosted the prices of tradable goods an **i** eroded the international reserves held by the Central Bank, which raised interest rates in ordîr to soak up liquidity and take pressure off ihe exchange market. Finally, and despite higher import levels, the decline in the supply of agricultural produce on the domestic market and the relative scarcity of certain basic manufactures paved the way for a price-based adjustment in product markets.

Amortization payments on the p ablic external debt exceeded incoming loan disbursements, thereby reinforcing the downward trend in the service on that debt. The progress made during the closing months of 1994, the country's structural reform plans, its incieased fiscal discipline, the conclusion of an agreement with the International Monetary Fund (IMF) and the rescheduling of its debt with the laris Club all appeared to herald a consolidî tion of the Dominican Republic's basic maoroeconomic balances in 1995.

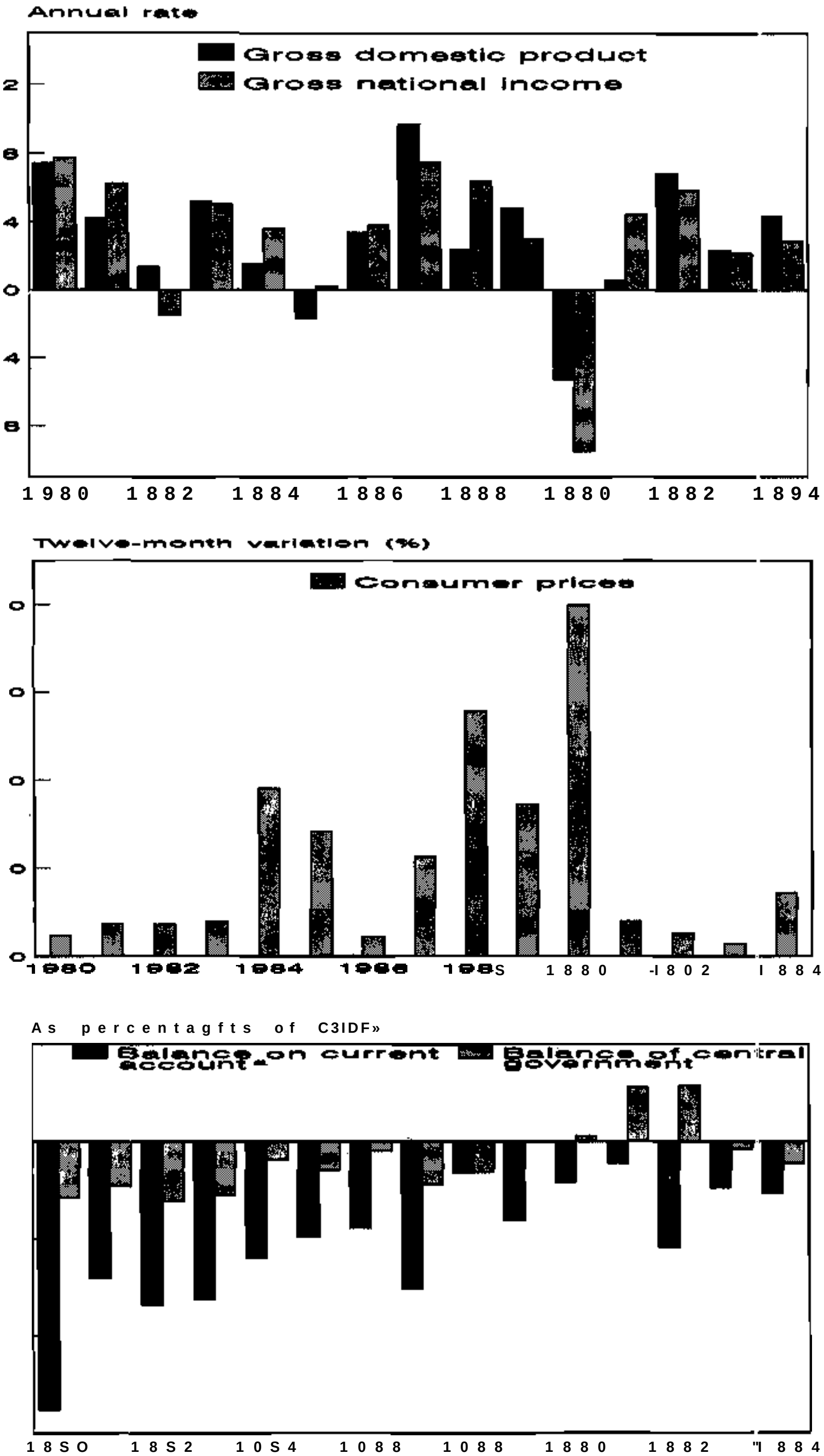
2. Economic policy

The country had steadfastly been applying stabilization measures ever since 1990, but some signs of backsliding were seen in the early months of 1994. In part, expectations took a turn for the worse as a result of the uncertainty associated with the election campaign. Another factor was the perception that tax receipts could not keep up with the steady expansion of public expenditure, as evidenced by tlie fact that between January and August the Fiscal deficit was twice as high as it had been dui ing the same months in 1993.

Other indicators also pointed to a deterioration in the situation during this period: by August, the prime rate offered by commercial banks stood at 26%, versus 19% iti December

Figure 1

DOMINICAN REPUBLIC: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.
a Of the balance of payments.

1993; the exchange rate on the non-bank market had climbed to 13.14 pesos to the dollar, while the official selling rate held at 12.50 pesos to the dollar; and the Central Bank's gross international reserves were drawn down by US$ 337 million during the first seven months of the year. Meanwhile, in the external sector, cross-border trade slumped due to the measures adopted by the United Nations in relation to the *defacto* regime in Haiti.

In September 1994, corrective steps were taken to restore the country's main macroeconomic balances. To this end, the Government engaged in operations on the open market in order to lower the economy's level of liquidity by issuing Central Bank pass-through securities at higher interest rates. Authorization was also granted for the exchange of export earnings from minor non-traditional products, which added to the supply of hard currency in the exchange market. Furthermore, steps were taken to enable the Central Bank to attract more foreign currency, and the peso was devalued to 12.87 to the dollar.

In an effort to control the expansion of the money supply, starting in September all credits granted to decentralized public-sector bodies by the State-run Banco de Reserva first had to be approved by the Monetary Board. The credit facilities which the Central Bank had placed at the disposal of the public and private sectors were suspended as well, and any funds in excess of the minimum reserve requirement which commercial institutions had deposited with the Central Bank were frozen until year's end; these deposits accrued interest at an annual rate of 12%.

a) Fiscal policy

In 1994 -an election year- the expansionary fiscal policy that had been implemented in 1993 was strengthened. Thus, whereas the central government's income climbed by 6%, its expenditures were increased by over 11%. Consequently, the fiscal deficit grew from 0.4% of GDP in 1993 to more than 1% in 1994.

Since tax receipts rose more slowly than nominal output, the tax burden shrank to 15% of GDP in 1994 (it had been 16% the year before). The country's high rate of tax evasion was apparently one of the reasons for ttiis. Revenues from indirect taxes rose much more sharply (21%) than direct tax receipts (4%).

The tax on petroleum (which tikes the form of the price differential between what the State oil company pays for hydrocarbons on the external market and the higher prio Î it charges on the domestic market for petroleum products) and the sales tax applying to mam factures and services both yielded higher reveni es. In the first case, the substantial increase was made possible by a decline in international oil prices and by an increased domestic use of fuel and stronger demand on the part of Haiti during the first six months of the year. The very prominent position of this levy in the country's tax structure does, however, make the country vulnerable to changes in the exchange rate and ir international hydrocarbon prices.

Revenues from taxes on goods and services swelled by 21%, but the share of total receipts provided by taxes on foreign trade diminished. One of the reasons for this was the large number of import exemptions which were granted.

The 18% rise in capital expenditure -chiefly because of a 26% jump in fixed inv ;stment- was one of the main causes of the increase in government spending. The upturn in current expenditure was smaller (5%), sine; the nominal reduction in transfers and interest payments largely offset the increase in expenditures on remunerations (18%) and on the purchase of goods and services (16%).

During the first months of tie year, the Government reduced its local-currency contributions to the Central Bank for domestic and external debt payments, but in S eptember the Dominican Oil Refinery resumed its practice of handing over the funds obtained from the above-mentioned hydrocarbons prke differential to the Central Bank.

b) Monetary policy

Up through August, monetary policy was geared to meeting the financial equirements associated with the fiscal imbalance and the private sector, and this had the effect of generating inflationary pre¡ sures and

Table 1

DOMINICAN REPUBLIC: MAIN ECONOMIC INDICATORS

	1987	1988	1989	1990	1991	1992	1993	1994[a]
	Growth rates							
Growth and investment								
Gross domestic product	9.7	**2.3**	**4.8**	-5.3	0.5	6.8	2.3	4.3
Per capita gross domestic product	7.3	0.1	**2.5**	-7.2	-1.5	4.7	0.4	2.4
Gross national income	7.5	**6.3**	**3.0**	-9.5	4.4	5.8	2.1	2.8
Gross domestic product by sector								
Goods	13.2	**-0.9**	**4.8**	-7.6	-0.8	9.2	0.7	5.4
Basic services	23.6	**0.6**	**5.4**	-6.6	6.0	15.3	7.5	4.2
Other services	4.8	**5.8**	**4.6**	-2.9	1.1	3.6	3.1	3.3
	Percentages							
Contribution to growth of GDP[c]								
Consumption	6.4	2.7	2.2	-7.4	5.6	5.5	-2.1	1.7
Government	-1.1	0.0	1.2	1.1	1.8	0.5	0.8	0.9
Private	7.5	2.8	1.0	-8.5	3.7	5.1	-2.8	0.8
Gross domestic investment	3.6	-0.6	2.9	-3.8	-1.8	4.5	1.6	1.4
Exports	3.4	0.5	-0.1	1.9	-1.7	1.5	2.2	2.7
Imports	-3.7	-0.3	-0.2	4.0	-1.5	-4.8	0.6	-1.5
	Percentages of GDP[b]							
Gross domestic investment	23.0	21.9	23.6	21.0	19.0	22.1	23.2	23.6
National saving	17.8	20.9	20.8	19.5	18.1	17.3	21.0	21.2
External saving	5.3	1.0	2.9	1.5	0.9	4.8	2.1	2.3
	Percentages							
Employment and wages								
Real minimum wage (Index: 1990=100)	128.9	133.9	119.2	100.0	101.6	123.7	117.6	125.0
	Growth rates							
Prices (December to December)								
Consumer prices	22.7	55.8	34.6	79.9	7.9	5.2	2.7	14.3
External sector								
Terms of trade (Index: 1990=100)	119.4	139.4	127.2	100.0	116.7	112.2	112.9	107.9
Nominal exchange rate (pesos per dollar)	3.85	6.11	6.34	8.29	12.61	12.79	12.68	13.16
Real effective exchange rate (Index: 1990=100)	130.2	151.0	109.2	100.0	100.6	101.9TÍ.8T96.2		
	Millions of dollars							
Balance of payments								
Current account	-422	**-84**	**-300**	**-162**	-93	**-530**	**-241**	**-281**
Trade balance (goods and services)	-389	-102	-351	-228	-229	-658	-345	-341
Exports	1 563	1903	2 077	2 005	1 979	2 093	2 339	2 537
Imports	1952	2 005	2 429	2 233	2 208	2 752	2 684	2 878
Capital account	275	194	298	170	434	557	330	-184
International reserves (variation)	**-189**	125	**5**		340	46	89	-389
	Percentages							
External debt								
Gross debt (as a percentage of GDP)	70.0	73.8	56.8	58.4	55.0	45.4	44.9	36.9
Net interest (as a percentage of exports)	19.6	14.2	6.0	7.9	3.7	5.7	6.4	5.2

Table 1 (conclusion)

	1987	1988	1989	1990	1991	1992	[993	1994[a]
			Percentages of GDP					
Central government								
Current income	14.6	15.5	13.5	10.3	13.1	15.4	16.1	15.0
Current expenditure	**7.5**	**7.5**	**6.7**	5.4	5.3	6.0	8.3	7.6
Saving	**7.1**	**8.0**	**6.7**	4.9	7.9	9.4	7.8	7.4
Capital expenditure	**9.2**	**9.5**	**6.8**	4.6	5.1	6.5	8.2	8.5
Financial balance	**-2.2**	**-1.6**	**-0.1**	0.3	2.8	2.9	-0.4	-1.1
			Growth rates					
Currency and credit								
Monetary balance of banking system								
Net international reserves					-294.2	53.8	45.3	-90.4
Domestic credit					5.5	24.4	17.4	39.7
Money (Ml)					27.6	15.3	25.1	2.3
Savings and time deposits (in local currency)					48.9	38.9	50.3	15.1
M2					37.4	27.1	*.11.9*	9.3
Dollar deposits						94.7	-71.4	-8.4

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. Based on 1980 dollars at constant prices. [c] These entries measure the impact o) the variation in each aggregate on the variation in GDP. The coefficients were obtained by multiplying each aggregate's annual growth rate by the level of that aggregate as a percentage of GDP. Refers to net interest as shown on the balance of payments, divided by exports of goods and services.

Table 2
DOMINICAN REPUBLIC: MAIN QUARTERLY INDICATORS

	1992				1993				19')4[a]			
	I	II	III	IV	I	II	III	IV	I	II	III	IV
Consumer prices (12-month variation, %)	-0.6	5.4	3.9	5.2	7.6	4.3	4.3	2.7	5.6	8.2	10.0	14.3
Real exchange rate (Index: 1990=100)	101.9	103.3	101.9	97.9	96.8	98.8	97.9	97.6	96.4	95.4	95.9	96.9

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures.

undermining confidence in the Dominican peso. From September on, however, monetary policy was tightened up once again.

For the year as a whole, the considerable decrease in international reserves played a decisive role in the reduction of the monetary base in nominal terms, since net domestic credit expanded sharply. This influenced the economy's other monetary aggregates. The money supply grew by only 2% in nominal terms, as sight deposits fell (-8%) and the amount of currency outside banks rose (11%) in response to the general public's preference for cash holdings, given the uncertainty that prevailed for most of the year. Hence, even though savings and term deposits climbed at much the same rate as inflation, total liquidity (M2) shrank in real terms.

Under these circumstances, commercial bank loans rose by 15% as the net result of a 16% increase in lending to the private sector and a 2% decrease in public-sector loans. Types of loans to the private sector exhibiting notable increases included personal loans (27%), construction loans (18%) and trade credits (18%).

The tight monetary policy adopted in September and higher inflation set the stage for an increase in nominal interest rates. Accordingly, the prime rate offered by commercial banks, which had been 19% in December 1993, rose to an annual level of 29% by the end of 1994. This meant that the real annual yields of lending rates held at around 13%.

c) **Foreign exchange and trade policy**

The country maintained its multi-tiered exchange system, which includes an official market for public-sector operations, an open bank market for private-sector imports and a parallel market. During the first eight months of 1994, the official exchange rate remained at 12.50 pesos to the dollar, despite the considerable drop in international reserves and the differential between domestic and external inflation. This rigidity in the face of a depreciation of the currency on the open market (the parallel-market rate was moving above 13 pesos to the dollar) sparked expectations of a devaluation along with capital flight. Finally, early iii September the monetary authorities announced a devaluation to 12.87 pesos to the dollar.

In 1994 the Dominican Republic joined the Association of Caribbean States (ACS) and signed the Partnership for Development and Prosperity agreement reached at the Summit of the Americas, thereby undertaking i commitment to greater intraregional cooperation. The Government also signed the agreement under which the World Trade Organisation (WTO) was created, even though it was still renegotiating the classification of eight agricultural products (sugar, beans, garlic, onions, poultry meat, maize, liquid milk and powdered milk) in view of the damage which the elimination of quantitative restrictions might ilo to that sector. The Government was also trying to secure the same benefits in terms of custoins-free areas for the Dominican Republic as those obtained by Mexico from the United States under the North American Free Trade Agreement (NAFTA).

The new Foreign Investment Act passed in the Chamber of Deputies, but the Senate had not yet approved the bill, and the delay was generating a measure of uncertainty among investors. This legislation would eliminate existing restrictions applying tc the repatriation of profits and capital gains as well as streamlining filing procedures.

As part of the Government's export promotion policy, work proceeded on the drafting of a bill on the clearance of merchandise exports which was aimed at defining the fiscal treatment to be accorded to imported inputs. The debate between the Government and private enterprise continued in 1994, with the Government espousing a scheme whereby drawbacks would be provido! once finished products had been exported, and the private business community advocating a system of temporary clearances for inputs which would guarantee the suspension of tariffs and additional levies.

d) **Structural reforms**

Despite the legislative steps taken to carry forward the structural reform process, very little genuine progress was made: the sale of semi-public companies that put a heavy burden on government coffers did not take place; the new Monetary and Financial Code, which would redefine the operational structure of public and private financial institutions, was still awaiting approval; authorization for the enactment of regulations to give effect to the Tax Code promulgated in May 1992 v/as still not forthcoming; and Congress failed to pass the electrical power omnibus act which the Executive branch had submitted to it the year before.

3. **The main variables**

a) **Economic activity**

The acceleration of the growth rate for GDP to over 4% (versus 2% in 1993) brought with it a further gain in per capita GDP, which thus continued to move closer to the level it had reached prior to the steep downturn experienced in 1990. The expansion of exports (13% in real terms) made a significant contribution to this trend. The increase in public spending (8%), both in investment and on consumption, was another important factor, whereas private consumption grew very little.

The expansion of investment (expressed in 1980 dollars) boosted this variable to nearly 24% of GDP in 1994. Capital formation was financed almost entirely with national savings, with external savings providing only one tenth of that total.

The upswing in the mining sector, which nearly doubled its output, accounted for over one third of the total increase; with a growth rate of 7%, construction also did its part, as did the 6% increase in the value added by commerce. Agricultural production faltered (-2%), however, following a year of listless growth.

The slump in agriculture was attributable to a drought in the northern, south-eastern and south-western parts of the country as well as to damage done by Hurricane Gordon in November, the persistence of crop diseases and a shortage of financing. Problems arose in terms of the flow of credit due to difficulties with the Agricultural Bank of the Dominican Republic's capital structure and the fact that few farmers actually hold deeds to their land, which means that commercial banks will not lend to them. The performance of the agricultural sector was somewhat uneven: export agriculture expanded but farming activities catering to the domestic market weakened, as did the forestry and fishery industries, while the livestock subs ;ctor's growth stalled.

Among export crops, the production of tobacco, cacao and coffee was boosted by higher international prices; the sugar-cane harvest was smaller, mainly because of bad weather conditions. Among crops intendec for domestic consumption, a decrease was seer in the output of rice, maize, peanuts, sweet potatoes, bananas, potatoes and tomatoes, while the production of beans, peas and yucca rose.

The sluggishness of the livestock industry was chiefly a result of the damage done 1 >y the drought to supplies of cattle feed, which tnnslated into a drop in the output of beef and mili. In contrast, the output of pork increased thanks to strong domestic demand and the settlement of overdue debts owed to producers. The poultry industry's results were mixed. The production of poultry meat expanded as a consequence of robust demand and the need to step up the rate of slaughtering in order to eliminate a glut of laying hens. The output of eggs was down slightly, however, due to low rates of return < nd marketing problems.

Mining activity rebounded vigorously from the steep downward slide of recent years thanks to the sector's increased producti *m* of nickel, gold and silver. The output of niel el received a strong boost from a 20% jumi[1] in average international prices and greater external demand for stainless steel. The upturn in gold and silver production stemmed from tie Rosario Dominicana company's resumption of operations in the second quarter of the year and climbing prices for both these **n**étals on the external market (10% and 32%, respectively).

Manufacturing activity was up due to a 7% increase in production in the couitry's export processing zones (EPZs) and a higher output of alcoholic beverages and tobacco. By the end of

1994, a total of 480 firms in 31 EPZ industrial parks were providing a total of about 176,000 jobs. On the other hand, the food industry recorded decreases in its output of sugar and flour and their derivatives. Particularly steep declines were observed in the production of raw and refined sugar and molasses owing to the use of outdated technology in the sugar mills overseen by the State Sugar Board (CEDAZU), shortcomings in the service activities involved in transporting sugar cane to processing plants, and a late start on the harvest. Consequently, 35,000 tons of refined sugar had to be imported during the closing months of 1994.

Construction benefited from a flurry of activity in public infrastructure works and housing projects. The most significant projects of this type were the expansion of the Duarte expressway, the construction of the Monción dam and of the Barahona international airport, the Santo Domingo-San Cristóbal highway, Mirador del Este park and the work involved in laying out 107 water supply systems in various areas of the country. Private construction also expanded owing to a more abundant flow of credit.

The more ample supply of electrical power available for sale (3%) was made possible by a sharp increase (85%) in the amount of energy purchased from the private sector by the State-run Corporación Dominicana de Electricidad, since its own generation of electricity was down by 7%. Given the steep reduction in the output of hydroelectric plants due to the drought, the pace of production had to be stepped up in the country's thermal, diesel-oil and gas-powered plants.

The level of activity in the financial sector was virtually identical to the rate registered for 1993. Communications services were expanded, primarily because of an improvement in telephone service triggered by increased commercial competition. Increased tourism boosted hotel, bar and restaurant services.

b) Prices, wages and employment

Following a three-year stretch of price stability, in 1994 inflation topped 14%. The largest increases for the year were in foodstuffs owing to prices hikes for a number of agricultural staples (e.g., rice, onions and ban anas) as a result of adverse weather conditions. Higher international coffee prices also made their effect felt in the domestic market. Li addition, the ascent of the exchange rate helped to drive up the prices of powdered milk and various types of medicines, as well as all the rest of the country's tradable goods.

The nominal minimum wage in large, medium-sized and small private firms climbed by 15% in January after having remained at the same level throughout 1992 anil 1993, but no change was made in the minimum wage for the public sector. In April, the National Minimum Wage Commission raised the minimum wage for firms in the EPZS by 10%.

The faster pace of growth resulted in no more than a small reduction in the country's high level of unemployment, with the rate dropping from 19% in 1993 to 16% in the first quarter of 1994.

c) The external sector

In the balance of payments for 1994, the deficit on current account widened and the capital account, which until 1993 had traditionally yielded a surplus, registered a deficit as well; consequently, international reserves shrank by over 3.5% of GDP.

The increase in the current-account deficit was a reflection of the deepening shortfall in factor services, which in turn was; a consequence of the results recorded for profit remittances and interest payments on the external debt. Meanwhile, the trade balance held virtually steady and incoming private transfers continued to rise.

The Dominican economy enjoyed a more favourable external environment during 1994, despite higher international interest rates and the trade embargo imposed upon the *defacto* regime in Haiti until October. The more rapid pace of growth in industrialized countries -especially the United States- and the expansion of international trade spurred on an increase in the volume of merchandise exports at the same time that the country's terms of trade took a turn for the better thanks to lower international oil prices and rising prices for such commodities as sugar, nickel, coffee, cacao and tobacco.

Given these circumstances, exports of goods and services rose in value (8%) somewhat more than imports (7%) did. With an increase in value of nearly 25% -owing to higher external sales of minerals, raw sugar, coffee and cacao-merchandise exports regained some of the ground they had lost during the preceding four years.

As total demand strengthened, the value of merchandise imports climbed by 8%, mainly because of an expansion in sales volume. Declining international oil prices made it possible to raise the level of imports. Increases were also seen in such items as motor vehicles, pharmaceuticals, and industrial machinery and equipment.

Tourism services, which provide more than twice as much foreign exchange as merchandise exports do, continued to mount thanks to an expansion of the country's lodging facilities and an improved international promotional campaign. In fact, hotel capacity grew by nearly 2,450 rooms, with this increase being distributed among 13 new hotel complexes.

The economic recovery in the United States stimulated exports from the EPZs (10%), since around 95% of their output is destined for that country. Another particularly noteworthy development was the steady growth of inbound unrequited private transfers in the form of remittances from family members living outside the country, which came to the eq livalent of two thirds of the Dominican Republic s merchandise exports.

The uncertainty associated wit ii the elections and the macroeconomic disequil bria observed during the early months of the yeai had an impact on the capital account. With the exception of incoming foreign direct investment, most of the country's capital flows exhibited negative balances.

On 30 August the Government signed an agreement with the public sector's private foreign bank creditors which cut the debt from US$ 12.5 billion to US$ 520 million -US$ 329 million of which was automatically redeemed with zero-coupon bonds. The con bined total of external public debt and government-guaranteed private-sector external debt dropped by 14%, bringing its end-1994 level to the equivalent of nearly 37% of GDP, or just hall of what the country's debt burden had been sb years earlier. The expansion of the Dominican Republic's multilateral debt can be attributed to the increase in its obligations with the Inter-American Development Bank (IDB), World Bank (IBRD) and IMF. Its bilateral debt, on the other hand, diminished; this was primarily a result of the reduction made in the country's debts with Spain and the United States, since th<; level of its indebtedness with Japan, France and Venezuela increased.

URUGUAY

1. General trends

The Uruguayan economy's growth rate accelerated to 5% in 1994. Meanwhile, inflation continued its gradual decline (falling to an annual level of around 45%), the country's external deficit remained quite high and its fiscal deficit deepened.

The momentum generated by total demand played a decisive role in bringing this about by helping to boost the growth rates for both the gross domestic product (GDP) and domestic prices above their projected levels, as well as in setting the stage for the upswing seen in merchandise imports. Specifically, the expansion of private expenditure (mainly consumer spending) and increases in the relevant components of external demand and inflation were pivotal factors in these trends.

Exports climbed rapidly, but imports rose even more sharply, and the deficit on the balance-of-payments current account therefore held at about 3% of GDP. As in earlier years, the inflow of external capital easily covered this shortfall and the country continued to build up its international reserves. The increase in fiscal expenditure, much of which was due to the heightened demands of the social security system, widened the non-financial public sector's deficit (which was covered with external loans) to 2.3% of GDP.

The administration which took office late in the first quarter of 1995 in the midst of a tumultuous regional and worldwide economic environment reaffirmed the objective of gradually lowering inflation as well as emphasizing the importance of reinforcing the country's external linkages via the Southern Common Market (MERCOSUR).

Accordingly, a high priority wis assigned to reducing the non-financial public sector's deficit through the use of an array of measures aimed at raising income while cutting back on current and investment expenditure. Mechanisms for providing relief from social secuity costs and drawbacks for exporters thus became key policy tools in the effort to make Uruguayan industry more competitive.

In a parallel initiative, the administration sought to build a political consensus regarding the introduction of substantive reforms in the social security sjstem, whose total disbursements were equivalent to 14% of GDP.

In the first quarter of 1995, the economy's growth slackened due to the 1'act that the strengthening of demand from Brc zil -an initial effect of the stabilization programme under way in that country- was far outwe ghed by the downswing in demand on the part of Argentina, whose economy was in the throes of a harsh domestic and external adjustment p rocess, and by the effects of Uruguay's internal fiscal adjustment effort.

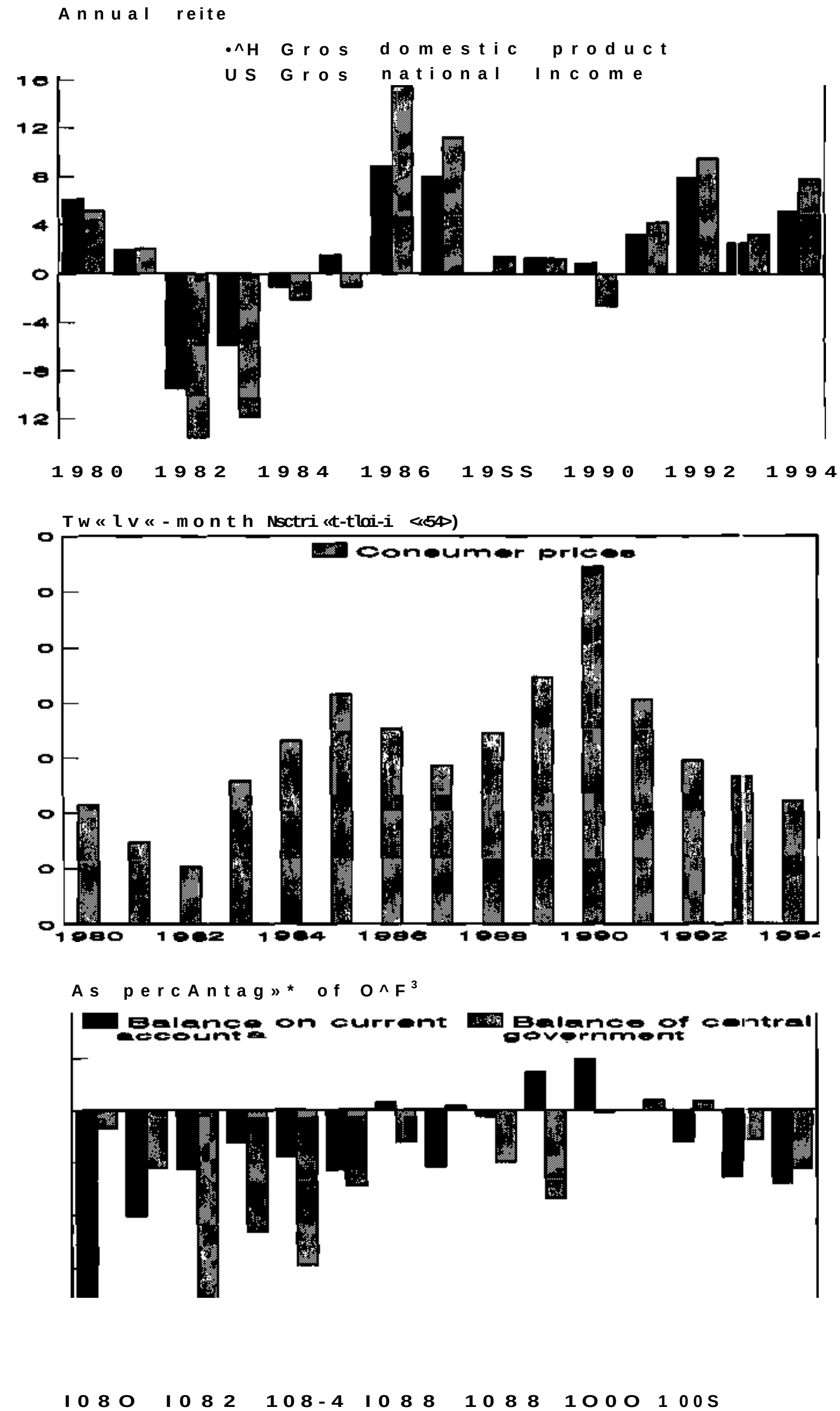
2. Economic policy

In the final year of its term, the administration which had taken office early in 1990 held to the principal objectives and instruments of the economic programme it had set in motion three years earlier. Lowering inflation continued to be its top priority and the exchange rate continued to serve as the primary instrumen : of domestic price formation.

The programme's targets for 1994 included bringing the annual rate of increase in consumer

Figure 1

URUGUAY: MAIN ECONOMIC INDICATORS



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prices down to 35% (from 53% in 1993). Based on a projected GDP growth rate of 2%, the programme was also aimed at reducing the financial imbalance in public-sector accounts in order to dampen the pressure for money creation. The authorities also continued to pursue the exchange policy that had been in place since 1991, which involved a currency band whose floor rate took the form of a crawling peg that was raised by approximately 2% per month. Given an external situation that appeared to promise a smaller trade deficit than before, the administration proposed to build up the country's international reserves by another US$ 50 million. Under these circumstances, the projected rate of monetary expansion was similar to the expected increase in nominal GDP. The programme also called for the alignment of wage trends with the targeted inflation rate.

The actual behaviour of these variables differed significantly from the projections, however. In particular, public expenditure climbed quite rapidly, thus causing the deficit to be larger than expected. Nevertheless, since the gap was covered with external resources, it did not generate pressure for money creation.

The influence exerted by the external sector, on the other hand, was more positive than expected, since the pace of the industrialized countries' economic reactivation picked up -although this also meant that interest rates on dollar-denominated funds rose more than had been projected. The start-up of the Real Plan boosted demand from Brazil and had considerable spillovers in terms of Uruguayan exports, which also benefited from higher prices in dollars for raw materials on the world market. The dollar's slide against Brazil's and the European Union's currencies enhanced Uruguay's external competitiveness, following a number of years during which the real effective exchange rate implicit in the country's foreign trade activity had been eroding. Ultimately, the country's stringent income policy was relaxed as the inflation rate stubbornly refused to follow its projected path.

a) Fiscal policy

The public sector's deficit doubled to 3% of GDP despite the fact that, in an attempt to move towards the re-establishment of the balance achieved in the early 1990s, the stabilization programme's objective had been to halve the preceding year's 1.5% deficit.

The deficit's growth was entirely attributable to a higher level of spending on the part of the central government, whose cash shortfall (not counting the net transfers received from State enterprises) shot up from 1.3% to 3% of GDP. Since income continued to climb in real terms, most of the responsibility for this adverse trend must be laid at the door of the increase in expenditure, which amounted to nearly 23% of GDP (21% in 1993).

The increase in transfers from State enterprises to nearly double their former level accounted for the bulk of the 5% expansion, in real terms, of inflows to the National Treasury. Meanwhile, the increase in tax receipts (2% in real terms) lagged behind GDP gnwth. Direct taxes held steady in real terms, as government revenues from income and agricultural property taxes sagged in nominal terms owing to the effect of tax provisions adopted the year before, while the real yield of indirect taxes climbed by a scant 2%. The steep rise in imports notwithstanding, revenues from taxis on foreign trade increased by only 4% in real terms. This was due both to the fact that avenge customs duties declined as the percentage of lhe country's imports purchased within the MERCOSUR customs-free area mounted and to the fact that the price of the dollar rose more slowly than domestic prices did.

The upswing in fiscal expenditure (10% in real terms) was chiefly a result of the trends in capital outlays and in transfers 1 o the social security system, which jumped 16% and 26%, respectively. The increase in public investment was concentrated in the acquisition of machinery and equipment. The amount spent on remunerations also rose steeply (8%), but interest payments on the public debt, measured in Uruguayan peso: at constant prices, shrank (-7%) thanks to this eu rrency 's rise against the dollar.

In order to prevent the growing deficit from putting pressure on monetary policy, the authorities resorted to external boi rowing. By this means they took in over US$;I00 million,

Table 1
URUGUAY: MAIN ECONOMIC INDICATORS

	1987	1988	1989	1990	1991	1992	1993	1994[a]
	Growth rates							
Growth and investment								
Gross domestic product	7.9	-	1.3	0.9	3.2	7.9	2.5	5.1
Per capita gross domestic product	7.3	**-0.6**	0.7	0.3	2.6	7.2	1.9	4.5
Gross national income	11.2	1.6	1.1	-2.3	4.2	9.5	3.2	7.8
Gross domestic product by sector								
Goods	9.0	**-0.6**	1.2	-2.0	1.2	6.3	-5.2	3.5
Basic services	7.7	6.1	2.6	3.6	9.2	13.1	7.1	6.8
Other services	7.1	0.9	2.9	1.9	1.3	4.7	4.7	3.1
	Percentages							
Contribution to growth of GDP[c]								
Consumption	11.1	0.1	0.1	-2.8	3.1	9.2	4.5	7.0
Government	0.8	**-0.3**	0.2	0.3	0.2	0.2	0.1	0.6
Private	10.3	**0.5**	-0.1	-3.1	3.0	9.0	4.4	6.4
Gross domestic investment	2.0	**-0.8**	-1.0	-	2.8	1.4	1.0	1.3
Exports	-1.9	0.3	2.2	3.8	0.9	3.7	2.4	2.8
Imports	-3.3	0.4	-	-0.2	-3.6	-6.4	-5.3	-6.1
	Percentages Of GDP							
Gross domestic investment	11.9	11.0	9.9	9.8	12.2	12.7	13.3	13.9
National saving	9.3	10.7	11.5	11.9	12.3	11.0	9.2	9.1
External saving	2.5	0.3	-1.6	-2.1	-	1.7	4.1	4.8
	Percentages							
Employment and wages								
Activity rate	60.3	59.4	59.7	59.4	59.6	59.5	59.0	60.6
Open unemployment rate[e]	9.3	8.9	8.6	9.3	9.1	9.0	8.4	9.1
Real minimum wage (Index: 1990=100)	106.7	102.3	109.7	100.0	103.8	106.1	111.2	112.2
	Growth rates							
Prices (December to December)								
Consumer prices	57.3	69.0	89.2	129.0	81.5	58.9	52.9	44.1
Wholesale prices	57.2	60.5	80.7	120.7	68.6	46.9	31.1	41.0
External sector								
Terms of trade (Index: 1990=100)	106.6	114.2	112.7	100.0	98.6	101.3	102.3	112.0
Nominal bank exchange rate (pesos per dollar)	0.227	0.359	0.606	1.17	2.02	3.03	3.95	5.06
Real effective exchange rate (Index: 1990=100)	80.6	86.7	86.3	100.0	88.1	84.1	74.2	74.7
	Millions of dollars							
Balance of payments								
Current account	-160	-19	113	162	2	-144	-338	-435
Trade balance (goods and services)	147	312	462	483	235	43	-197	-239
Exports	1589	1753	2 032	2 159	2 201	2 533	2 562	3 159
Imports	1442	1441	1570	1675	1966	2 490	2 759	3 398
Capital account	248	36	-19	-10	153	234	445	556
International reserves (variation)	39	35	104	142	156	93	106	124
	Percentages							
External debt								
Gross debt (as a percentage of GDP)	79.9	84.4	89.1	89.5	75.2	65.4	60.4	53.9
Net debt (as a percentage of GDP)	37.8	42.2	41.4	35.5	25.7	20.6	18.3	17.9
Net interest (as a percentage of exports)	17.6	17.4	17.2	14.9	10.5	7.1	5.3	6.2

Table 1 (conclusion)

	1987	1988	1989	1990	1991	1992	1993	1994[a]
				Percentages of GDP				
Non-financial public sector								
Current income		21.8	23.0	28.1	30.5	31.4	30.5	30.8
Current expenditure		22.4	22.6	23.2	21.4	25.9	26.5	27.7
Saving		2.4	0.4	4.9	6.1	5.8	4.0	3.1
Capital expenditure		3.8	3.5	3.8	3.8	3.7	0.8	5.4
Financial balance		-1.4	-3.1	1.1	2.3	2.1	-0.7	-2.3
				Growth rates				
Currency and credit								
Monetary balance of banking system								
Net international reserves	91.7	58.2	156.5	161.1	66.9	45.8	25.5	38.9
Net domestic credit	52.5	112.3	100.8	95.5	89.2	49.5	39.0	37.5
To the public sector	34.2	106.6	77.6	85.0	17.7	60.1	17.3	64.0
To the private secator	62.5	75.4	73.5	87.6	65.8	70.2	46.8	40.1
Money (Ml)	69.6	62.4	68.9	112.5	91.5	70.1	58.4	39.6
Savings and time deposits (in local currency)	51.6	54.6	52.3	69.6	68.3	43.9	35.3	21.1
M2	59.3	58.1	60.0	90.7	81.1	59.2	49.8	33.4
Dollar deposits	72	97.2	142.2	131.1	77.7	45.7	29.5	39.2
				Annual rates				
Real interest rates (annualized)								
On deposits		-0.7	-2.3	-13.1	-3.1	-2.9	-8.7	-4.9
On loans		19.5	20.3	20.5	39.8	37.0	29.4	35.5
Equivalent interest rate in foreign currency		8.7	4.7	0.4	10.9	9.1	10.3	9.0

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. Based on 1980 dollars at constant prices. [c] These entries measure the impact o; ' the variation in each aggregate on the variation in GDP. The coefficients were obtained by multiplying each aggregate's annuel growth rate by the level of that aggregate as a percentage of GDP. Percentages of the working-age population. [e] Pi rcentages of the economically active population (EAP). Interest rate on deposits, deflated by the variation in the exchange ate.

Table 2

URUGUAY: MAIN QUARTERLY ECONOMIC INDICATORS

	1992				1993				1994[a]			
		II	III	IV	I	II	III	IV	I	II	III	IV
Gross domestic product (Index: 1990=100)	109.5	110.6	112.1	112.7	114.3	112.0	114.2	116.3	117.1	121.1	120.4	121.5
Consumer prices (domestic) (12-month variation, %)	78.8	69.9	63.4	58.9	54.3	56.4	53.0	52.9	47.9	42.6	41.3	44.1
Real exchange rate (Index: 1990=100)	84.5	85.8	85.0	81.0	77.4	75.5	72.8	70.9	70.7	70.6	78.6	79.0
Real interest rate (annualized, %)												
On deposits	-2.4	3.6	-12.2	-0.7	-9.9	-16.5	-7.6	-0.7	1.6	-5.6	-6.8	-8.6
On loans	35.5	43.5	26.1	42.7	28.5	17.2	28.7	43.2	45.9	35.3	31.5	29.4
Money supply (Ml)[c] (12-month variation, %)	82.3	110.5	91.3	54.8	67.7	47.1	48.3	61.0	46.7	47.0	45.0	37.7

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] On the basis of non-seasonal ly adjusted figures at constant national prices. [c] This differs from the heading "Money (Ml)" which appears in table 1 owing to a dissimilar coverage of sight deposits.

with 60% of that sum being obtained through the issuance of government securities, including US$ 100 million in Euronote sales. This strategy proved viable, thanks to the moderate level of the net debt burden at the start of 1994 and to the steps taken in previous years to improve the country's debt profile.

After having posted surpluses for a number of years, State enterprises ran up a small deficit, much of which was attributable to the sizeable transfer payments they made to the central government. Quasi-fiscal expenditure edged downward to the equivalent of 0.7% of GDP (from 0.8% in 1993).

b) **Exchange policy**

The upcoming elections influenced economic agents' expectations, prompting them to buy up foreign currency in the third quarter. As a result, the exchange rate for the dollar crept up to the ceiling of the currency band established in 1991 -which allows the currency to float within a 7% margin- after having hovered near the floor rate for several years. The pressure on the foreign-exchange market soon eased off, however, due to the effect of open-market operations at high interest rates, which tightened up the money supply; the enhancement of Uruguay's competitive position in relation to Brazil, owing to the effects of the Real Plan; and the fact that uncertainty concerning the country's future exchange policy was dispelled. As 1994 drew to a close, the rate for the dollar had fallen back to the floor of the band.

Even though the price of the dollar climbed more slowly than domestic prices did, the real effective exchange rate (measured on the basis of a basket made up of the currencies of Uruguay's main trading partners) rose 10% between the end of 1993 and the end of 1994. The reversal of the ongoing downward trend exhibited by this indicator ever since 1990 has been attributed to the depreciation of the dollar against European currencies and to Brazil's introduction of a new monetary unit which quickly strengthened against the dollar. The net result of all this, however, was only a slight rise in the average annual rate.

c) **Monetary policy**

Within the framework of its foreign exchange system, Uruguay's monetary policy was endogenous at the boundaries of the currency band but became more aggressive within that band and, as mentioned earlier, this is what occurred during the third quarter of 1994.

The administration's programme called for an expansion of about 40% in he amount of currency outside banks. One fourth of this gain was to come from an increase in international reserves; the rest -equivalent to 1.4% of GDP- would take the form of credit for the non-financial public sector. The resulting increase in the quasi-fiscal deficit was to be offset by operations with the rest of the iinancial system and international loans. This level of money creation was tantamount to the imposition of an inflation tax equivalent to about 1.5% of GDP.

In practice, however, the use of external finance to cover the fiscal shortfall had the effect of tightening up the flow of credit to the public sector. In addition, the gain of nearly US$ 230 million in the Central Bank'; international reserves outstripped initial estimates. As a result, the increase in the money supply (43%) overshot the target figure by a slight amount. Nevertheless, unlike the situation during the preceding two years, in 1994 lhe build-up of reserves via net public debt placements exceeded net purchases on the foreign-exciange market.

For virtually the entire year, the yields of the interest rates offered on deposit! were negative in real terms. Local-currency time deposits climbed by a scant 21%, and broad money (M2) therefore expanded by 33%. The coefficient for the broadly-defined money supply thus moved lower once again, falling to 8.1% of GDP. Meanwhile, foreign-currency time deposits swelled by 10% to US$ 5.76 billion. Most of this amount, which represented almost two fifths of GDP, was recycled abroad as part of the off-shore banking strategy adopted by the Uruguayan financial system after the crisis of the early 1980s.

Credit to the private sector was up by 40% as the net result of a downturn, in real terms, of local-currency credit and an expansion of credit in dollars. Once again, a highly significant aspect of the flow of commercial bank loans to the private sector was the jump (by 43% in real terms) in consumer credit, which thus came to represent 18% of the total -double the size of its share just five years earlier,

d) **Trade policy**

The end of 1994 marked the completion of the total rollback of tariffs among the countries belonging to MERCOSUR (Argentina, Brazil, Paraguay and Uruguay), and a limited customs union entered into operation on the first day of 1995. The countries have drawn up lists of exceptions (covering a very large number of products, in some cases) which are to be phased out over the next five years. Thus, as of 1 January 2001, a full-flee ged customs union will be in place, with no taxes on foreign trade among its members and eeual tariffs (at rates ranging from 2% to 20% ol the imported value) on products purchased from outside countries.

3. **The main variables**

a) **Economic activity**

The strengthening of private expenditure and the expansion of external demand, both from the region and elsewhere, doubled the growth rate for GDP to 5%, while imports mounted by a factor of nearly one fifth.

With an increase of 9%, private consumption continued to boom, as it has been doing since 1992, thus becoming the single most important factor in the country's economic activity. The jump in consumption, measured in 1980 dollars, represented over 6% of Uruguay's 1993 GDP.

The drop in public investment was largely offset by the momentum of private investment, and consequently the rate of fixed capital formation only slipped to 4%. The coefficient for fixed investment (in 1980 dollars) remained at a meagre 13% of GDP. A considerable build-up of inventories added one percentage point to the coefficient for total gross investment. As in 1993, almost one third of this investment was financed by external funds, while national saving contributed scarcely 9% of GDP.

The buoyancy of exports, which rose by 8% in volume, was another mainstay of total demand. The spurt in purchases by Argentina during the first three quarters was buttressed by a sizeable increase in the acquisition of Uruguayan products by Brazil in the second half of the year, following the introduction of the Real Plan.

Another significant factor was the upturn in purchases of Uruguayan merchandise by European countries as their economies made a vigorous comeback. The increase in the value of exports was attributable in part to higher prices, particularly in the case of traditional export products, and in part to an expansion in the total level of shipments.

GDP growth picked up speed ;n the second quarter, accelerating to a level 3% ibove the rate for the first quarter and 8% higher than the corresponding quarter in 1993. The upsurge in services was a decisive factor in this respect. The transport and communications sector and the category of commerce, restauran s and hotels were the most dynamic components as domestic consumption soared and tourists ¡ treamed into the country during the early part of the year. The statistical effect of the taxes levied on imported merchandise -which is included in the computation of total GDP at cons imer prices- was again highly significant. The production of goods also rebounded, thanks in paiicular to the manufacturing sector's recovery (}%) from its steep slide of the year before (-9%). Furthermore, if the negative effect of the tempon ry closure of the country's fuel processing plan (which was shut down early in 1993 for remodeling) were to be factored out, then manufacturing activity would actually have risen by around 6%. This positive trend was, however, coupled with a further increase in unemployment d íe to gains in productivity and the increased substitution of imports for Uruguayan-made inputi.

The improvement in Uruguay's competitive position *vis-à-vis* Brazil served as an incentive both for branches of industry that primarily cater to the external market and for import-substitution industries. Activities that did not have to deal with foreign competition also experienced rapid growth, however. The machinery and engineering sector, and within that category the automotive industry in particular, marked up the highest growth rate (37%), followed by leather manufactures, footwear, paper, metal products and foodstuffs. Activity slackened, on the other hand, in the basic metals, glass, textiles and garment industries. Oil refining plunged to negligible levels due to the shutdown of the country's refinery.

The agricultural sector expanded by over 4%. Bolstered by an upsurge in grain and oilseed harvests, crop-farming climbed by 8% (after having slipped back by 10% the year before), which brought it back up to its 1992 production levels. In the livestock industry, solid increases in cattle and dairy production outweighed the drop in wool output. Record levels of meat output were made possible by gains in productivity per hectare, and the size of herds was therefore unaffected. This expansion of supply coincided with considerably stronger demand from Brazil and the deregulation of exports of beef on the hoof.

The fact that Uruguay was certified as being free of hoof-and-mouth disease improved the outlook for the cattle industry by giving it ready access to United States and Asian markets. The new international trade agreement, which rolls back tariffs in importing countries and reduces subsidies for European Union exports, will have much the same type of effect.

In contrast, a slump in construction followed on the heels of three exceptionally good years. Activity in the private sector continued to rise at an annual rate of over 7%, but public-sector construction plummeted by around 8%.

b) Prices, wages **and employment**

In an economic environment marked by heavy domestic demand, inflation continued to be fueled by the underlying inertial aspects of the country's widespread price- and wage-correction mechanisms, which are based on past inflation rather than on its projected trend.

The rate of devaluation (27% per year) acted as the main brake on the prices of tradables. Its effect was, however, partly offset by the higher levels of those components of external inflation relevant to the country, particularly the inflation rates observed late in the year in Brazil, following the adoption of the Real Plan. The 12-month increase in the consumer price index declined steadily throughout the first three quarters, and in September reached its lowest point (41%) since 1982; its pace picked up sortiewhat in the last quarter, however (44% in December).

The behaviour of wholesale prices, on the other hand, followed neither th.is pattern nor the trend observed in recent years. Since 1991, the movement of the wholesale price index had been very heavily influenced by th<; increase in the exchange rate, since the bulk of its components are tradable goods. Accordingly, its response to rises in the exchange rate had been much swifter. In fact, this was so much tie case that its 12-month rate of increase as of the end of 1993 was around 30%; this was just slightly higher than the rate of devaluation, which remained virtually unchanged until Auguiit. During the last four months of the year, however, it climbed to 41% -thus approaching the rate registered for retail prices- in reaction to steeply rising prices for livestock products and a rapid expansion of external demand, which tended to push domestic prices üp to the higher price levels found on international markets.

In keeping with firmly entrenched inertial guidelines, wage corrections fo lowed consumer price movements very closely. Consequently, the increase in the average real wage bordered on 1%. In a departure from earliei years, when the trends in public- and private-sector wages had been strikingly different from one another, in 1994 wage adjustments in the two sectors were similar.

Job growth was not rapid enough to meet expanding demand, and unemployment therefore rose above 9%, which was one point higher than the year before and similar to he rate recorded at the start of the 1990s. Unemployment was the most severe in manufacturing, where it averaged nearly 10% for the year and hit a high of 12% in the third quarter, but it was also considerable in commerce (almost 9%) and construction (7%).

These figures suggest that total wages did not improve by any appreciable amount despite the upsurge in economic activity. Nevertheless, after having bogged down the year before, average household income -which includes other types of factor compensation and interest income- was up by more than 7% and thus exceeded its 1990 level by a full third. If the appreciation of the local currency during this same period is taken into account, then the purchasing power of the average level of household income, expressed in dollars, turns out to have doubled in the last four years.

c) **The external sector**

For the second year in a row, the balance-of-payments current account showed a deficit amounting to about 3% of GDP. Once again, however, an abundant inflow of external capital easily covered this sizeable shortfall. The steady increase in the country's external trade in goods and services boosted the coefficient that measures how open the economy is (based on figures for both exports and imports of goods and services) to over 42% of GDP.

The merchandise trade deficit widened to more than 4% of GDP. The value of exports, which had been at a standstill for the past five years, jumped by 16%, but even so was once again outpaced by imports (22%). The upswing in exports was buttressed by sales of both traditional products, which soared by 30%, and non-traditional items, which expanded 11%. The increase in traditional exports, which were boosted by stronger demand from Brazil -particularly for beef on the hoof at a time when cattle were in abundant supply- and by higher international prices, was more than enough to make up for the ground lost the year before (-16%). The growth of non-traditional exports was also helped along by an increase in purchases by Brazil following the implementation of the Real Plan, but was chiefly (two thirds of the total increase) a result of higher sales of motor vehicles to Uruguay's partners in MERCOSUR under the terms of bilateral agreements. The increase in value was attributable in equal proportions to higher volumes and higher prices.

Merchandise imports continued along their upward path. This was particularly true of purchases of raw materials and intermediate goods, which were up by 24%. The fact that this increase was five times as great as the expansion of industrial output signals the presence of a larger imported component in final product values. Although the growth cf imports of consumer goods (19%), which wai; concentrated in non-durables in 1994, was slower than in the past, it also had an appreciable impact. Imports of capital goods edged up by only 5 % overall, but the rise was steeper in the case of nachinery and equipment.

The country's hefty deficit in merchandise trade was largely counterbalanced by the surplus it achieved on the services axount. One particularly important compone: it was gross foreign-exchange earnings from tourism, which were equivalent to one third of the] woceeds from total merchandise sales. Conseque itly, the trade balance narrowed to 1.5% of GDP. Met payments for factor services swelled by almost 40%, however, owing to increases in boh the level of payments falling due and average : nterest rates.

Capital inflows amounting to 3.6% of GDP provided more than enough to finance the deficit on the balance-of-payments curren account, and the official banking system (which includes both the Central Bank and the Banco de la República Oriental del Uruguay) therefore continued to build up its reserves, adding another US$ 124 million (the equivalent of nearly one point of GDP).

The country received a copious inflow of long-term external capital (4.5% of GDP); this included a sharply higher level of direct investment, which accounted for one fourth of the total. A portion of this was composed of investments made by foreigner:! in lodging facilities located in resort areas, and another portion corresponded to acquisitions and capital investments in Uruguayan firms. Portfolio investment, including Euronote p acements on the world market, accounted for another 25% of the total. The other half was made up of increased borrowing by the public sector and by commercial banks. In contrast, shoit-term capital inflows shrank. A turnaround was seen in 1994 in the errors and omissions entry, which registered a negative net result, bul much of this change was due to the efforts made to improve the measurement of some service activities. Thus, part of the expansion reccrded for the tourism industry was accountec for by the statistical effect of the inclusion of new sources in the relevant calculations.

Heavier external borrowing drove up the level of the foreign debt in both gross and net terms. Since the increase in exports of goods and services was greater, however, the net debt/GDP ratio slipped below 18%. The coefficient which measures the country's burden of debt service as a percentage of exports also improved, falling to just one fifth.

VENEZUELA

1. General trends

The recession which swept over the Venezuelan economy in 1993 deepened in 1994. In the wake of the political and economic instability of the year before, a severe crisis erupted in the financial system which caused expectations to take a turn for the worse and generated sharp imbalances in exchange and money markets, GDP shrank by 3% and inflation heated up in the first half of the year, closing out 1994 with a 71% increase in the consumer price index (CPi) within an economic environment influenced by exchange and price controls. Although these controls, which were introduced late in June, were adopted as a temporary measure by the administration that had taken office in February, they none the less signalled a turnaround in economic policy five years after the initiation of a liberalization programme.

This recession in the domestic economy gave rise to a striking improvement in tie country's trade balance and current account, since exports increased while imports declined substantially. An upturn in demand and in international prices for crude oil in the second quarter was also a contributing factor. On the other hand, the instability of the country's financial markets precipitated a heavy outflow of capital and the withdrawal of foreign (especially portfolio) investors. This led to a net loss of re¡:erves which -although it was curtailed in the second half of the year- took on disturbing proportions during the first half.

2. Economic policy

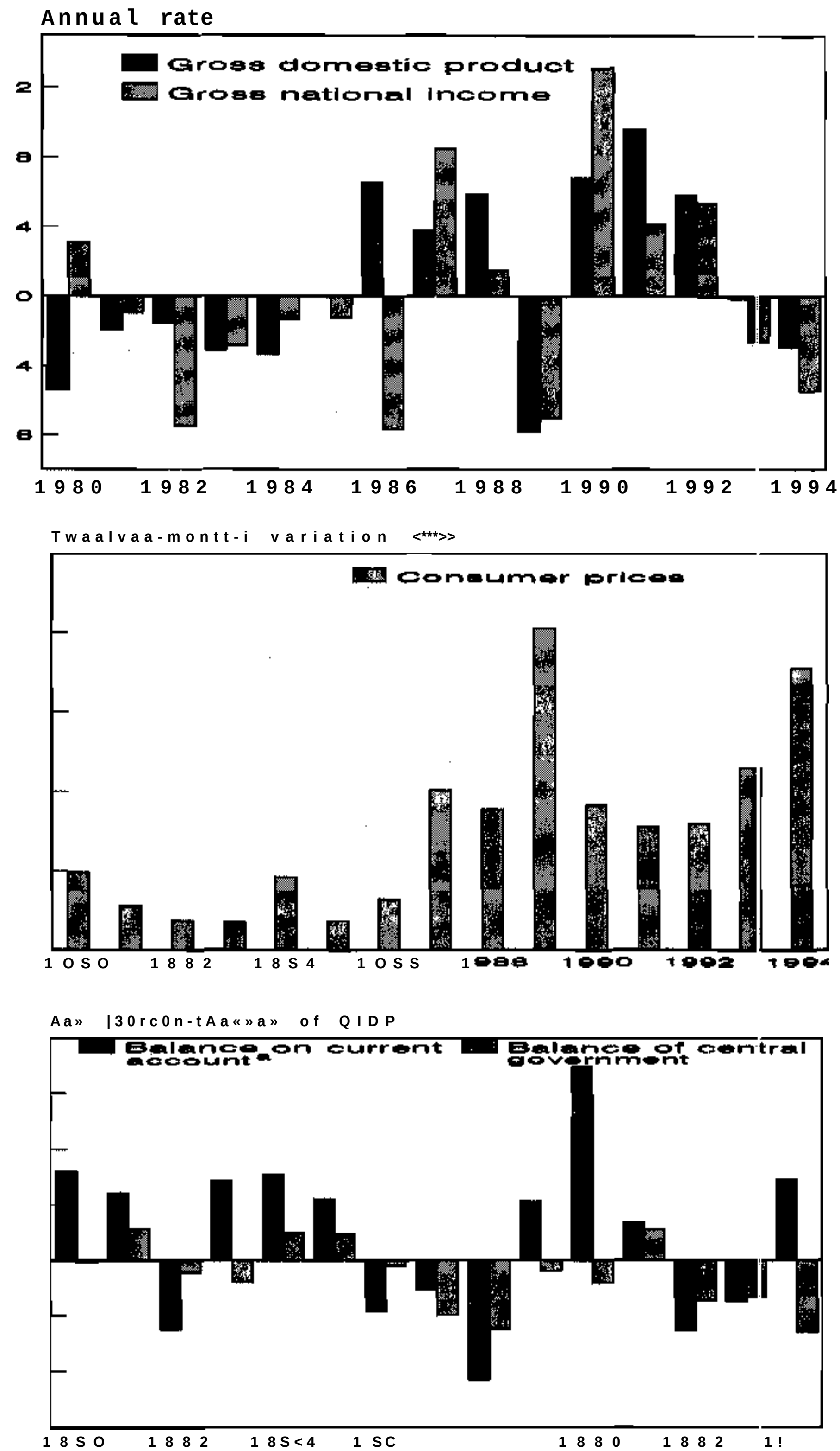
From the very start of 1994, the overriding consideration in economic policy was the need to deal with the critical situation existing in the banking system, which had been brought on by a series of bank failures and by circumstances requiring government intervention in a number of financial institutions. This thwarted the public sector's plans to find new sources of income that would enable it to balance its fiscal accounts. Meanwhile, Venezuela's monetary authorities, who were obliged to finance the Government's attempts to bail out the country's faltering banks, had to marshall their efforts to counteract the resulting excess liquidity in order to lessen its impact on prices and the value of the bolivar. Given the difficulties involved in fulfilling these different objectives at one and the same time, midway through the year the Government decided to impose exchange and price controls, thereby suspending the operation of market mechanisms in the most troubled seg ments of the market.

In June 1994, Venezuela, Colombia and Mexico (known as the "Group of Three") signed a free trade agreement which was then ratified by the Venezuelan Congress in December. This agreement, which entered into force sn 1 January 1995, provides for successive tariff reductions (10% per year) for trade amon; the three countries, with the exception of the agricultural sector (which is not covered by the agreement). Venezuela has participated in a customs-free trade area with Colombia since 199! Î.

a) Fiscal policy

From the first days of 1994 on, fiscal authorities worked to curb the fisca deficit that had carried over from the preceding year. The size of this shortfall (about 3% of the country's

Figure 1
VENEZUELA: MAIN ECONOMIC INDICATORS



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GDP in 1993) seriously jeopardized Venezuela's chances of achieving a macroeconomic equilibrium and, hence, of realizing its economy's potential.

To this end, the Government enacted a policy package designed to boost its income. The measures making up this package included income tax reforms, the substitution of a luxury tax and a sales tax on wholesale transactions for the value-added tax (VAT) that had been introduced the year before (which had been applied only at the wholesale level), a new tax on bank debits, and legislative and institutional reforms aimed at reducing tax evasion and improving tax collection procedures.

Thanks to these measures, the central government's non-oil revenues more than doubled to over 810 billion bolivars (versus 360 billion in 1993). Of that amount, 262 billion was generated by the new tax levied on sales at the wholesale level and 110 billion by the new tax on bank debits. Income tax receipts climbed by around 40%, but the collection of customs duties rose only 20% as a consequence of a decrease in imports.

The increase in the Government's oil revenues was considerably smaller (36%), mainly because of a further reduction in what is known as the "fiscal export value", which is a percentage that is added to the value of sales in order to calculate the tax base for the income taxes to be paid by the State-run oil company, Petróleos de Venezuela, S.A. (PDVSA). This coefficient was lowered in accordance with a schedule which provided that it be set at 19% in 1992,16% in 1993, 8% in 1994,4% in 1995 and that it be eliminated altogether in 1996.

As a result, the percentage increase in the central government's total income was quite similar to the average annual rate of inflation, thereby outdistancing the nominal growth rate for GDP. In qualitative terms, a highly significant change in its income structure took place. For the first time in decades (with the exception of 1986, when international prices for crude oil had collapsed), non-oil income exceeded oil revenues and thus accounted for more than half of all current income. The share of income provided by oil revenues has been on the wane ever since 1990, when it stood at over 80%.

For the public sector as a whole, however, oil revenues (the operating surplus of PDVSA before taxes) still made up 57% of current income, although this share, too, has been on the decline from the 77% level recorded in 1990. In 1994, dollar earnings from the oil company's sales improved substantially, although their contribution in terms of the local currency was smaller than it would otherwise have been due to the real appreciation of the bolivar. Total public income soared by nearly 80%, thereby boosting its share of GDP by four points to r early 30%.

Meanwhile, expenditure skyrocketed due to the magnitude of the crisis that had engulfed the banking system in December 1993. After the Government had to take over th<! reins of the Banco Latino when it was declaed insolvent, other banks saw their depositors' confidence in them evaporate and had to seek official financial assistance from the Deposit Insurance and Bank Protection Fund (FOGADE), which look charge of these institutions' assets. Late in Ju îe, after it had become necessary to intervene in a number of different banks, the Government set up a stringent regulatory scheme to oversee Venezuelan financial institutions. Over the course of the year, FOGADE supplted 1.1 trillion bolivars in aid, which was equivalent to more than 13% of GDP. In exchange, the Fund received 300 billion bolivars from the centra I government, whose capital outlays increased by ; i like amount.

It did not prove possible to make any sizeable cuts in current expenditure either Almost two thirds of the central government's current disbursements went for interest payments on the public debt and for constitutionally-mandated transfers to regional and local govt rnments. The sum paid out in the form of inteiest payments doubled while transfers swelled by 80%. The only items of expenditure that the Government was able to reduce were civil-service wages, which fell in real terms, and investment, whose nominal increase of just 15% contrasted with an expansion of nearly 80% in the investments made by PDVSA in the country. Consequently, central government expenditures rose by ever 90%.

Owing to the credit granted bj FOGADE, an even larger increase was seen in the consolidated public sector's spending levels, which jumped by a factor of 2.3 (measured in current bolivars). Its

Table 1

VENEZUELA: MAIN ECONOMIC INDICATORS

	1987	1988	1989	1990	1991	1992	1993	1994[a]
				Growth rates				
Growth and investment								
Gross domestic product	3.8	5.9	-7.8	6.8	9.7	5.8	-0.2	-2.9
Per capita gross domestic product	1.1	3.1	-10.2	4.2	7.1	3.4	-2.4	-5.1
Gross national income	8.5	1.5	-7.0	13.1	4.1	5.4	-2.6	-5.5
Gross domestic product by sector								
Goods	3.9	6.1	-9.2	9.6	10.7	6.1	1.2	-2.8
Basic services	7.6	8.0	-4.6	1.1	5.7	5.1	1.4	-1.2
Other services	4.8	5.8	-6.0	4.6	7.9	5.0	-1.7	-2.4
				Percentages				
Contribution to growth of GDP '								
Consumption	3.1	**5.5**	**-7.6**	2.4	6.3	6.4	-0.7	-4.8
Government	0.4	1.3	**-0.3**	0.7	2.0		-0.6	-0.5
Private	2.7	**4.2**	**-7.3**	1.7	4.3	6.4	-0.1	-4.3
Gross domestic investment	2.3	**2.7**	-10.3	-0.8	6.9	5.4	-3.4	-7.4
Exports	-0.3	**2.8**	**1.3**	5.0	2.6	-1.5	2.2	3.5
Imports	-1.3	**-5.2**	**8.7**	0.3	-6.2	-4.5	1.8	5.7
				Percentages of GDP				
Gross domestic investment	17.9	19.5	10.0	8.7	14.2	18.6	15.2	8.1
National saving	15.6	10.8	13.6	20.8	16.6	13.9	12.5	13.2
External saving	**2.3**	**8.7**	**-3.5**	-12.1	-2.4	4.7	2.7	-5.1
				Percentages				
Employment and wages								
Activity rate	56.2	56.7	57.5	58.6	60.1	59.6	58.2	59.1
Open unemployment rate [e]	9.2	7.3	9.2	10.4	9.5	7.8	6.6	8.5
Real minimum wage (Index: 1990=100)[f]	192.9	163.3	126.1	100.0	86.9	123.6	106.3	116.7
				Growth rates				
Prices (December to December)								
Consumer prices	40.3	35.5	81.0	36.5	31.0	31.9	45.9	70.8
Wholesale prices	48.1	17.0	106.2	20.4	23.1	26.0	47.4	89.5
External sector								
Terms of trade (Index: 1990=100)	88.0	73.8	88.4	100.0	81.4	80.0	74.6	73.4
Nominal exchange rate (bolívares per dollar)	14.02	16.61	34.68	46.91	56.82	65.60	87.30	141.50
Real effective exchange rate (Index: 1990=100)	83.9	81.2	96.1	100.0	93.9	88.5	88.9	94.2
				Millions of dollars				
Balance of payments								
Current account	-1 372	-5 785	2 177	8 303	1 769	-3 747	2 216	4 132
Trade balance (goods and services)	320	-3 891	4 716	9 336	2 683	-1650	-296	5 812
Exports	11428	11052	14 028	18 818	16 405	15 530	15 604	17 459
Imports	11108	14 943	9 312	9 482	13 722	17 180	15 900	11647
Capital account	15	2 054	-2 045	-5 361	456	2 717	2 232	-4 916
International reserves (variation)	-1095	-3 871	95	2 826	2 258	-1032	-30	-850
				Percentages				
External debt								
Gross debt (as a percentage of GDP)	57.3	64.3	84.6	73.6	68.5	64.9	67.0	68.5
Net interest (as a percentage of exports) [8]	13.2	14.7	16.2	4.1	3.2	9.2	8.8	8.2

Table 1 (conclusion)

	1987	1988	1989.	1990	1991	1992	1993	1994[a]
			Percentages Of GDP					
Central government								
Current income	18.1	18.2	19.5	22.7	22.9	17.8	16.8	18.5
Current expenditure	17.6	18.5	17.2	19.3	17.7	16.1	15.5	21.6
Saving	0.5	-0.3	2.3	3.4	5.2	1.7	1.3	-3.1
Capital expenditure	5.5	5.9	3.3	5.5	2.4	5.3	4.7	3.4
Financial balance	-5.0	-6.2	-1.0	-2.1	2.8	-3.6	-3.4	-6.5
			Growth rates					
Currency and credit								
Monetary balance of banking system								
Net international reserves	25.5	-25.4	211.9	69.4	51.0	18.9	11.7	36.8
Domestic credit	43.2	41.6	-21.1	49.4	47.2	17.5	48.2	77.1
To the public sector		811.3	87.0	0.6	-63.2	191.0	:>81.0	
To the private sector	38Í2	30.8	13.2	25.1	47.9	33.1	12.0	-6.7
Money (Ml)	34.1	22.8	9.5	41.2	51.2	8.3	10.6	121.9
Savings and time deposits (in local currency)	36.9	9.1	64.2	72.5	48.7	23.3	32.1	31.1
M2	35.6	15.1	38.6	60.9	49.5	18.4	25.7	55.1
			Annual rates					
Real interest rates (annualized)								
On deposits		-17.2	-24.0	-2.3	3.9	7.0	16.9	-11.0
On loans		-17.5	-27.8	3.6	11.3	15.0	24.8	2.6
Equivalent interest rate in foreign currency		9.0	-20.3	15.3	12.6	9.1	29.6	9.4

Source: ECLAC, on the basis of official figures.
* Preliminary figures. Based on 1980 dollars at constant prices. [c] These entries measure the impact (if the variation in each aggregate on the variation in GDP. The coefficients were obtained by multiplying each aggregate's annual growth rate by the level of that aggregate as a percentage of GDP. Percentages of the working-age population. [e] Percentages of the economically active population (EAT). From June 1992 on, this includes special meal and transportation tllowances. [g] Refers to net interest as shown on the balance of payments, divided by exports of goods and services. Interest rate on deposits, deflated by the variation in the exchange rate.

Table 2
VENEZUELA: MAIN QUARTERLY INDICATORS

	1992				1993				1<>94"			
	I	II	III	IV	I	II	III	IV	I	II	III	IV
Consumer prices (12-month variation, %)	31.5	31.9	31.8	31.9	34.1	35.9	39.0	45.9	47.5	60.2	69.6	70.8
Real effective exchange rate (Index: 1990=100)	91.0	88.3	86.1	90.7	90.0	88.8	87.9	85.5	83.8	97.1	101.6	88.2
Real interest rate (annualized, %)												
On deposits				...	14.8	23.4	12.8	16.7	17.3	-19.0	-19.0	-23.3
On loans				...	24.6	33.7	21.1	19.9	32.8	-6.4	-7.8	-8.1

Source: ECLAC, on the basis of official figures.
* Preliminary figures.

share of GDP therefore surged from less than 29% in 1993 to more than 43% in 1994, saddling the public sector with a deficit equivalent to about 14% of GDP. Of this sum, 9% corresponded to the deficit run up by FOGADE and 6.5% to the central government's financial shortfall; in contrast, PDVSA posted a surplus amounting to 0.3% of GDP and the rest of the public sector reported a 1.4% surplus.

In all, 3.6% of the central government's deficit was attributable to the capital endowment of FOGADE. Another 2%, approximately, stemmed from the losses incurred by the Central Bank of Venezuela (whose accounts are included in the central government's) in the course of the operations it had to undertake on the open market in order to soak up some of the liquidity generated by the financial assistance that was provided. Apart from these two items, the operation of the central government showed a deficit of less than 1% of GDP. On the other hand, if the Central Bank's quasi-fiscal deficit is added to the 13% of GDP represented by direct assistance (divided up between FOGADE and the central government), then a financial drain equivalent to a very large percentage of GDP (close to 15%) can be directly attributed to the banking crisis.

b) Monetary policy

The course of action followed by the Central Bank of Venezuela was strongly influenced by the emergency situation existing in the financial sector, since this is what made it necessary for the Central Bank to supply credit to the public sector so that it could assist banks in distress, thereby triggering the expansion of the monetary base and liquidity. Moreover, in order to help out banks faced with a liquidity crunch, a window for overnight funds was re-opened and reserve requirements were eased, with the minimum reserve being lowered from 15% to 12%. Given these circumstances, the Central Bank undertook weekly sales of zero-coupon bonds on the open market in an effort to siphon off excess liquidity.

As a consequence of the financing provided to aid the country's banks, the net amount of credit furnished by the Central Bank to the public sector climbed by nearly 850 billion bolivars and figured as the main cause of the monetary base's expansion. The extension of credit was concentrated in the first half of the year, and during that period the Central Bank absorbed more than 315 billion bolivars (lhe equivalent of two fifths of the assistance provided by FOGADE during the same period) through its sales of zero-coupon bonds.

This liquidity overage fueled the demand for goods and services, as well as for foreign currency, as the local currency s buying power weakened and inflationary expe< nations ran high. Given the nature of the exchang e policy applied by the Central Bank, which was based on the use of a crawling peg and called upon the Bank to meet the market's foreign-exchange requirements at a pre-determined exchange fate, the heavier demand for foreign exchange made it necessary to draw down the country's international reserves. The Central Bank was forced to allow the value of the bolivar to fall much more sharply than anticipated, and it therefore proceeded to set up a controlled float of the currency; later on, this float was implemented under a system of daily foreign-exchange auctions.

Near the close of the second quarter, an additional spurt in the demand for foreign currency drove down the bolívar sharply and prompted the Government to establish a full-fledged system of exchango controls and to set the prices of certain essential goods and services. The rate for the dollar was raised to 170 bolivars, which signified a 60% devaluation since the start of the year. Up lo that point, the Central Bank's efforts to shore up the currency had cost it more than US$ 3 bil ion.

The rationing of foreign exchange allowed the Central Bank's international reserves to recover, but it also heightened the pressure generated by the domestic economy's excess liquidity. The Central Bank reacted to this situation by selling off more than 260 billion bolivars worth of zero-coupon bonds during the second half of the year. Although the banking system's cash holdings climbed somewhat and the monetary base expanded by 64% during the year, the money supply (Ml) more than doubled, with the currency multiplier increasing significantly.

Given the imbalances in the credit market associated with the banking crisis and the recession, during the second half of the year the higher level of liquidity sparked a steady decline in nominal interest rates. Rates on deposits, which had reached 80% early in the year, had fallen to 26% by November, although they then rebounded by a slight amount; at these levels, real interest rates were extremely negative. This trend was a contributing factor in the contraction of time deposits, with the result that total quasi-money expanded only 32% in 1994as the public's prefc rence shifted towards more liquid types of assets. Rates on loans, for their part, dropped from 90% to 54%, which also made for negative real yields (although they were high in Jollar terms, since the dollar's parity had been fixed since June). In an economy riIdled with uncertainty, the monetary authority sought to provide guidelines for the market by pegging increases in the minimum authorized level for interest rates to the yields of 90-day zero-coupon bonds.

3. **The main variables**

a) **Economic activity**

The recession deepened in 1994, following the slump in activity observed the year before. Total GDP shrank by nearly 3%; however, if the petroleum sector -which accounted for one fourth of GDP- is not included in the calculations, then the size of the contraction rises to about 5%. Per capita GDP also sank by 5%, for a cumulative loss of more than 7% over the last two years. Gross national income was almost 6% lower owing to both a downturn in net income from abroad under the heading of factor services and a deterioration in the terms of trade.

Because the public sector plays such an important role in capital formation, the sharp cutback in public investment was one of the main factors driving down domestic demand and economic activity. The level of public investment felt the full force of the difficulties experienced by the public sector and of its subsequent efforts to reduce spending in order to pare down its huge fiscal deficit. Unlike what occurred in 1993, this time private investment also declined (by almost one fifth) due to the adverse expectations engendered by the prevailing climate of economic instability, the disorganization of financial intermediation activities occasioned by the banking crisis, the high interest rates in effect until mid-year and, possibly, the difficulties encountered in obtaining imported inputs and capital goods during the second half of 1994.

The 25% drop in fixed investment, which was the second decrease in as many years, pushed the level of investment to a low of 16% of GDP. A substantial downswing was also observed in inventories, equivalent to almost *8%* of GDP. This poor showing was made in spite of a higher level of national saving, which climbed to 13% of GDP.

Consumption fell much less steeply than investment, but the adverse impaci of its decline was just as great because consumpt ion represents such a large share of total demand. Public-sector consumption was down by over 4% and the decrease in private consumption was even sharper. This trend was matched by a 7% downturn in total supply as the cont raction of GDP was compounded by a 30% reduction in the volume of imports.

The combined effect of this lower level of domestic consumption and an uptt rn in external demand was to boost exports by 10%. Exports of crude oil rose by a similar amount : n the wake of an upswing in output brought about by the development plan set in motion by PDVSA the year before. In fact, oil production climbed from less than 2.6 million barrels per day to over 2.7 million, and the petroleum industry was therefore one of the few sectors to record < n increase in output (of nearly 6%) in 1994.

Other production activities that did well were the mining of substances other thun petroleum, which expanded 8%, and the electri :ity and water sector (up 1%). All the main mining products boasted significant increases, especially bauxite (60%). The production of diamonds, gold and iron ore gained back some of the g'ound lost the year before.

The petroleum sector's momem um spread to the petrochemical industry. The output of plastics and olefins, in particular, increased considerably. This was also true of aluminium, but quite the opposite occurred in the case of steel and steel rods. A moderate increase in the production of tyres was also recorded. The GDP for the manufacturing sector as a whole slipped by 4%, however.

The sector that was hurt the most by the economy-wide recession was construction, which plummeted 26%. Here, too, the main cause was the slackening of public-sector activity. Commerce was hurt as well, with the volume of transactions falling off by 13%. The automotive industry's sales plunged 40%, but the decrease was even greater in the case of imported motor vehicles.

In agriculture, whose aggregate output also diminished (-3%), the results for the different crops were quite uneven, although many of those that had suffered setbacks in 1993 rebounded in 1994. The more prominent exception was cacao, whose output continued to decline.

b) **Prices, wages and employment**

Prices were influenced by the large amount of liquidity that was injected into the banking system during the first half of the year, when the local currency was rapidly depreciating, and by economic agents' predominantly adverse expectations. The rate of price increases picked up speed and by the end of the year had passed the 70% mark, thus coming quite close to the record high set in 1981.

In February 1994, the increase in the CPI for the Caracas metropolitan area began to follow a geometric progression; this set up a feedback loop between the CPI and economic agents' expectations, until late in June the Government decided to impose price controls on selected essential goods and services. This made it possible to slow down the CPI, although late in the third quarter and early in the fourth, it began to be evident that pressure had been building up due to economic agents' limited access to foreign exchange, which was in its turn a consequence of the exchange controls then in force.

All the major product groups contributed to the ascent of the general index, but the largest increase was in the category of food, beverages and tobacco; this was also the only group in which the rate of price increases exceeded the index average. Generally speaking, goods exhibited sharper price hikes trian services did, and within that category, the price increases for durable goods were substantially above those registered for non-durables. In the case of services, prices rose more sharply in the private sector than in the public sector.

Wholesale prices climbed even more steeply. The wholesale price index (WPi) for imported products (mainly manufactures) doubled during the year, whereas the WPI for Venezuelan-made goods marked up an increase of 86%.

In order to cushion the real wages of low-income workers from the adverse impact of rising prices, the Government raised the legal minimum wage from 9,000 to 15,000 bolivars per month in urban areas and from 7,000 to 12,500 bolivars in rural areas. These pay hikes boosted the purchasing power *of* the urban and rural minimum wages by nearly 6% and 4%, respectively. Low-paid workers also received an additional allowance equivalent to 40% of the monthly urban minimum wage.

The slump in the production sector of the economy also had a negative influence on the labour market. Job creation fell short of the growth in the labour force, and unemployment therefore mounted from 6.6% in 1993 to 8.5% in the second half of 1994. This was a reflection both of higher unemployment among persons previously employed (slightly more than 7% of the economically active population (EAP)) and of an increase in the proportion or that population seeking work for the first time (1.3%).

Two factors appear to have helped prevent the increase in open unemployment from being even greater. First, the crop-farming ¡sector offered an alternative source of jobs for some of the people who could not find work in urban areas, since -in contrast to the situation in the rest of the economy- a striking increase was registered in the number of persons employed in the primary sector. In the construction industry, the number of employed persons diminished in absolute terms; this was also the case in the services sector, with the exceptions of commerce and transport. The rate of joblessness among previously-employed persons therefore increased in the secondary and tertiary sectors, with construction being the industry with the highest level of previously-employed persons who were out of work (around 15% of the labour force).

Second, some of the people who were laid off appear to have moved into the informal sector of the economy, inasmuch as the percentage of total jobs accounted for by this sector, which had hovered around 40% since the early 1980s (30% in the late 1970s), climbed to about 50% in 1994.

c) **The external sector**

The situation prevailing during the last two years, which was marked by a deficit on current account and surplus positions on the capital account, did an about-face in 1994. The current account boasted a surplus of over US$ 4 billion, thanks to an even larger trade surplus (US$ 5.8 billion) while the deficit in factor services stayed within the same range as in the two preceding years. This overage of current income as compared to current payments was countered by a deficit in capital transactions amounting to over US$ 4.9 billion.

Consequently, the country rounded out the year with a loss of over US$ 800 million in reserves; this figure was, however, in large part a reflection of the exchange controls established midway through the year, which successfully reversed a free fall in the level of reserves that was estimated, at that point in time, at over US$ 3 billion. At the close of 1994, Venezuela's reserves amounted to some US$ 12.5 billion, which would be enough to finance about one year's worth of imports.

The country's hefty trade surplus was attributable to both a strong export performance and a drop in imports. The export sector, in its turn, had responded to robust external demand and sluggish demand at home. The export item that benefited the most from this situation was crude oil, since increases in the volume of external sales (from 1.5 to 1.7 million barrels per day) and in the price of crude (from US$ 12.10 to US$ 12.30 per barrel) pushed the value of crude oil exports 6% above their 1993 level.

The slackening of both demand and consumption in the domestic economy sparked a 33% jump in non-traditional exports which carried them to an all-time record level. All the major export products were sweot up in this boom, with the expansion of (nan-monetary) gold sales by the Central Bank of Venezuela being especially notable. Accordingly, non-traditional exports' share of otal external sales continued to grow -reaching 27% in 1994- while the share accounted for by petroleum showed a matching decrease. Nevertheless, petroleum sales still generated almost three fourths of Venezuela's export earnings.

Colombia was once again the country's largest export market, followed cosely by the United States. These two countries were the destination for over one half of Venezuela's external sales, which was a slightly higher proportion than in 1993.

Merchandise imports weakened for the second year in a row, falling in value to about US$ 8 billion, or 30% less than in 1993 (39% below the 1992 level). The decrease in volume was even greater, however, since average price levels were up. This result can be ascribed to listless domestic demand and the difficulty of obtaining foreign exchange during the second half of the year, after exchange controls had been imposed. Capital goods imports (-33%), which were hurt by cuts in corporate investment, and imports of consumer goods (-31%] were hit the hardest.

Capital movements reflected the instability of exchange and financial markets in 1994, especially in the first six months of the year, when a great deal of foreign exchange flowed out of the country. Overall, the main causes of the deterioration in Venezuela's capital account were a reversal in portfolio investment's direction of flow, a reduction in tlie amount of long-term credit at the disposal cf the public sector and the departure of short-term private capital. The country did, however, receive a positive net flow of direct investr lent (around US$ 140 million), which represented a turnaround from the year before, when the net flow had been negative.

The outward flow of portfolio investments, which amounted to nearly -US S 1 billion, followed a positive inflow of over US$ 700 million in 1993. Long-term loans r&xived by the public sector tumbled from nearly US$ 700 million to US$ 270 million, thus falling more steeply than in the private sector. The outflow of private short-term capital, which had amounted to US$ 700 million in 1993, topped US$ 1.3 billion. On the other hand, the accumulation of interest arrears on the external public debt helped to check the deterioration of the capital account.

Amortization payments were almost halved, and the servicing of the total external debt (predominantly public debt) therefore declined by about US$ 1 billion. The tightness of external credit also led to a reduction of roughly the same amount in the country's level of indebtedness, which thus slipped below US$ 39 billion.

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