

UNITED NATIONS

**ECONOMIC COMMISSION
FOR LATIN AMERICA
AND THE CARIBBEAN - ECLAC**



Distr.
LIMITED

LC/L.2147
31 May 2004

ENGLISH
ORIGINAL: SPANISH

**ECLAC: PRIORITIES FOR LATIN AMERICA AND THE CARIBBEAN
IN THE COMING YEARS**

This document was prepared by José Luis Machinea, Executive Secretary of the Economic Commission for Latin America and the Caribbean (ECLAC).

04-5-0424

In the half-century since its founding, the Economic Commission for Latin America and the Caribbean (ECLAC) has made significant contributions to the region's economic and social development through interactive cooperation with Governments in the region and around the world.

After an era of high State intervention and protectionism, it was expected that market-oriented reforms, including trade liberalization, would provide the basis for rapid growth in the developing world, particularly in the context of globalization. Although the 1990s were characterized by major macroeconomic achievements, such as falling inflation, rapid export growth and increasing foreign direct investment, they were also a time of mediocre economic growth (averaging 2.6% a year), weak overall productivity performance and high levels of unemployment, poverty and income disparities.

Thus, for the Latin American and Caribbean countries, the expectations generated by economic reform have not been met, creating a great deal of frustration in many cases. One of the lessons learned is that macroeconomic stability, open economies and more active private-sector participation in the production of goods and services are not enough to induce growth, let alone lead to development, understood as sustainable growth with social equity. As history shows, development is a complex process and, even more importantly, a process that hinges on the particular features of each country. In fact, development calls for virtually tailor-made strategies that take country-specific political, economic, institutional and social circumstances into account.

We have also learned that, from a macroeconomic point of view, low inflation and a manageable public debt are crucial elements of any strategy, but are not enough. Sustainable current-account deficits, "right" relative prices and policies aimed at saving in the "good times" so that countercyclical policies can be implemented are also crucial elements of a development strategy. The rule of law and compliance with contracts should go hand in hand with more active State participation in the design and implementation of policies for making systemic changes in the production structure. These policies should include innovation (the creation, adaptation and adoption of new technologies), human capital accumulation and incentives for small- and medium-sized enterprises and for the creation of new enterprises and new dynamic sectors. Such policies are essential for influencing the pace of economic growth. A smaller State does not mean an absent State, as many claimed during the 1990s. In Latin America and the Caribbean, the counterpart to "more market" must be a better State.

The challenge is how to pursue these policies in a globalized world. We believe that there are clear advantages to be gained from strengthening regional and subregional integration schemes as a platform for worldwide integration. One alternative, as ECLAC has indicated a number of times, is open regionalism. Latin American and Caribbean integration has been subject to strong tensions in recent years, which can only be overcome through a renewed political commitment to deepening current integration processes. This means that beyond trade liberalization and the design of common trade rules, there is a strong demand for macroeconomic and financial cooperation, harmonization of regulatory regimes, complementary physical infrastructure, defence of regional commons and gradual progress towards social integration.

To address these challenges, ECLAC proposes that greater emphasis should be placed on the following five priority issues:

- **Hemispheric integration.** The proliferation of bilateral agreements between Latin American and Caribbean countries and the United States shows that it is harder to forge strategic

alliances among the Latin American and Caribbean countries, with a view to regional integration, than it was in the past. While these agreements may be advantageous from the viewpoint of the specific countries concerned, they offer bleak prospects for the region as a whole. Low bargaining power, diversion of trade to the North at the expense of intraregional trade and high transaction costs related to multiple rules of origin are among the problems created by this scenario. Given the growing number of these agreements, it is important to consider how they can be made compatible with the deepening of regional integration. The way they affect and are affected by subregional treaties needs to be understood. ECLAC should provide the countries with technical advice in their multiple negotiations and should offer guidelines to serve as inputs for the design and implementation of the best regional strategy in these circumstances.

- **Increasing the region's productive potential.** The transformation of production structures must be an explicit priority of any development strategy. Progress on this front requires innovative public-private partnerships, suitable and strategic State policies and efficient institutions. As will be discussed below, ECLAC is taking a closer look at different strategies aimed at increasing the productive capabilities of the Latin American and Caribbean countries. Its efforts are focusing on policies that help create flexible economic structures capable of incorporating knowledge, value added and wider access to world markets.
- **International migration.** For several decades the region experienced too much capital mobility and too little labour mobility. However, in the last decade the relative importance of emigration to the North has become apparent. Remittances from such emigrants to their countries of origin have increased substantially, and last year infused more funds into the region than foreign direct investment. Growing international labour mobility is posing new challenges on both the economic and social fronts, particularly for women and youth. The links between the social and economic impacts of remittances in terms of poverty and productive activities must be assessed. This topic raises a number of issues: the economic drive behind migration, financial linkages between emigrant workers and their families in the home country, cultural and political integration of migrants, etc. ECLAC is addressing this problem by taking into account the complexities of the issues involved and making proposals that can be incorporated into the countries' public policies.
- **Improving social cohesion.** High poverty rates and huge disparities in income distribution are widespread in Latin American and Caribbean countries. While progress on this front requires that the development process be set on a firm footing, some of these challenges can be addressed under social policies. Political efforts must therefore be made to design a fiscal covenant that meets the need to finance social safety nets and, at the same time, to develop human and social capital. In that regard, the impact of different social policies on income distribution and poverty must be assessed.
- **Sustainable development.** The effective incorporation of the environmental dimension into the development agenda places additional demands on economic and social strategies. ECLAC is focusing its efforts in this area on analysing the links between economic and environmental considerations. In this connection, it is exploring the opportunities opened up by the internalization of environmental costs in dynamic production sectors through technological innovation and clean production methods and by efforts to capitalize on the region's unique natural resource endowment, including its added potential to provide environmental services of global public benefit.

Many of these issues were the focus of the various world conferences held in the 1990s, culminating in the Millennium Summit, at which the heads of State of most of the countries members of the United Nations adopted the Millennium Development Goals as a road map for combating poverty. ECLAC, in line with its mandates, is actively working on the integrated follow-up of these global conferences from a regional perspective, with the aim of providing cooperation and support to its member States, particularly with regard to the evaluation of progress and proposals for achieving the Millennium Development Goals.

Last but not least, the effects of various economic and social developments on the political stability of the region's fragile democracies merit a great deal of attention as part of United Nations efforts in the area of conflict prevention. This requires a coherent United Nations agenda at the regional level and will require us to review inter-agency cooperation, together with the other agencies and organizations of the multilateral and inter-American systems, with a view to building stronger institutions organized into a regional network that serves as an intermediary between the global and national orders. ECLAC is particularly well positioned to meet these challenges, while offering a multidisciplinary method of analysis that is highly responsive to the region's specific traits and is aimed solely at helping States to further their economic and social development.

This year, from 28 June to 2 July, the Commission's thirtieth session will be held in San Juan, Puerto Rico. The Commission's sessions, held in every two years with the participation of its member States, offer an excellent opportunity for the ECLAC secretariat and Governments to collaborate in assessing the region's economic, political and social situation, identifying emerging issues and priorities and determining what instruments ECLAC can place at the service of development in the countries of the region.

As is traditional at ECLAC sessions, the secretariat would like to take the opportunity afforded by the San Juan meeting to analyse in depth one of the five issues outlined above that is of particular interest to the member countries. The issue selected for this session is "Productive development in open economies".

To provide a basis for the analysis of this topic, and in line with its usual practice, the secretariat is preparing a document that will be made available to the member countries duly in advance of the meeting. Adopting a multidimensional perspective, the document looks at productive development policies in Latin America and the Caribbean in the context of open economies and reflects the Commission's most recent analyses and conclusions concerning the interrelationship between macro- and microeconomic policies.

Since the hopes of faster growth and greater equity that were raised by the reforms carried out in the region in the 1990s have been frustrated, a new paradigm must be developed, based on the understanding that the countries need not only "more market", but also better government. What is more, there is a growing consensus that "more market" without complementary public policies not only is insufficient, but also may be counterproductive, in many cases, for achieving sustained growth and better income distribution.

The need for public policies designed to boost productive development immediately raises the question of what strategies are most appropriate in this regard. Some of the ground rules for such strategies are that they must be shaped by a sense of the region's history, with its hits and misses; be based on an understanding of each country's current circumstances and future potential; reflect an awareness that productive development policies pose different challenges in open economies than they

did during the import-substitution period; take into account both the budgetary constraints related to social demands and the countries' institutional capacity for economic policy-making; and build on the premise that the implementation of public policies and the achievement of certain objectives go beyond the scope of State initiatives and require interaction with the private sector.

A survey of current conditions in the region shows, as ECLAC has pointed out time and again, that development is substantially more uneven in Latin America and the Caribbean than in other regions and that this situation largely prevents productivity gains in certain sectors from generating spillovers for the rest of the production system. This persistent unevenness is reflected by the existence of three types of actors in the production system, which progress at different speeds and may be grouped into three broad categories based on their size or their legal status in the economy: informal enterprises, small- and medium-sized enterprises (SMEs) and large enterprises. Informal enterprises, owing to the features of their structure and capacity, have the lowest productivity and operate in an environment that affords them few learning opportunities. Formal SMEs have few resources with which to build their capacities, usually operate in undemanding markets and have little chance to benefit from externalities that would boost their competitiveness. Lastly, the most advanced segment, consisting of large firms whose productivity comes close to the international frontier, generally lacks the capacity for innovation.

Productive development strategies face an enormous challenge, since faster productivity growth cannot be confined to a specific area of the economy (big companies, export firms or high-productivity enclaves), but must also boost the efficiency of technologically backward firms, shortening the distance between them and the top performers. In other words, the structural unevenness that has characterized the region for decades must be smoothed out.

Thus, the challenges still facing the region in this area are: (a) to narrow the productivity gap vis-à-vis the international frontier; (b) to reduce the unevenness of development; and (c) to promote a more knowledge-intensive pattern of external economic integration with higher local value added. Productive development policies must therefore focus on the incorporation of knowledge or innovation, defined as the capacity to adopt, adapt and create knowledge.

It is also necessary to implement specific sectoral policies. While these policies must take existing comparative advantages into account, they should seek not only to enhance competitiveness but also, in particular, to add value and knowledge to activities that can capitalize on the dynamism of external markets. The creation of new sectors linked to primary export activities is part of a successful strategy used in a number of countries rich in natural resources, and may be an interesting option for the region. In addition, manufacturing sectors that do not depend on natural resources—an area in which the region's linkages with the world economy have increased—would benefit from policies for developing new activities that would enable the countries to export more domestic value added and, in particular, more knowledge. Lastly, the generation of dynamic comparative advantages in areas where there are human or natural resources whose potential has not yet been tapped would open up opportunities for creating new activities.

As noted earlier, the design of productive development strategies must be based on the recognition that the resources available for this purpose are far more modest today than they were in the days of import substitution. This means that policy makers must be very selective in terms of policy orientation and must design instruments with great care, adapting them to the need to offer “soft incentives” instead of the “hard incentives” of the import-substitution period. Moreover, special attention must be paid to implementation-related issues and to the strengthening of impact assessment mechanisms if the policies put in place are to be effective and enjoy public legitimacy.

Productive development policies cannot live up to their potential unless they are implemented in an environment conducive to productivity gains. The session document accordingly discusses the need to reform the labour market to make it compatible with globalization, while not neglecting the need for social safety nets.

Furthermore, growth without due regard to environmental protection is not only undesirable, but also unsustainable in the long term. This consideration is particularly relevant for countries whose exports are based on natural resources. Moreover, as argued in the document, environmental sustainability represents an opportunity for productive development in the region. Other key issues are the need for adequate infrastructure development and for regulatory frameworks that enable productivity gains to be transmitted to the entire production system.

The analysis also covers the issue of appropriate institutional frameworks for development, and notes that macroeconomic policies should be geared to preventing the wide swings in GDP growth rates seen in the last decade and to generating sufficient financing for productive activities. Lastly, on the subject of development in open economies, the document completes the analysis with an overview of the international environment and of the challenges and constraints it imposes on the region. In this connection, one of the highlights of the document is a discussion of mechanisms for forging linkages with the global economy through bilateral, regional and multilateral agreements.

The Puerto Rico session will provide a fresh opportunity to open up a dialogue between the member countries, represented by their economic and political authorities, and a group of distinguished experts drawn not only from the United Nations, but also from the multilateral banking system and the private sector. It is our hope that this dialogue will result in the identification of guidelines for strengthening cooperation between ECLAC and its member States in the coming years.