

LIGHTS AND SHADOWS IN LATIN AMERICAN STRUCTURAL REFORMS

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I. INTRODUCTION

No other region in the developing world embraced structural reforms earlier and more enthusiastically than Latin America. The transition economies of Central and Eastern Europe did so, but somewhat later and as a result of radical political change. Structural conditionality since the 1980s is certainly part of the explanation but, in a strong sense, "ownership" characterized the push towards a more liberal economic order in Latin America. Indeed, the regional democratic wave that started in the mid-1980s progressively embraced structural reforms as part of its agenda. Furthermore, the "Washington Consensus", as presented by Williamson (1990), was largely based on Latin American debates and ongoing reforms.

The enthusiasm for reforms was associated to the dominance that orthodox economic thinking had acquired by the mid-1980s. The call for reforms was presented as an alternative to state-led industrialization, a development strategy that, according to orthodox analysts, had generated inefficient productive and State structures, as well as a bias against labor demand. In Latin America, the need to overcome the "lost decade" of the 1980s also generated a very concrete source of support for reforms. It is now increasingly clear that the criticisms of state-led industrialization were simplistic ¹ and the expectations generated by the reform process

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¹ For an alternative, recent evaluation, see Cárdenas, Ocampo and Thorp (2000). For the reasons that are extensively discussed in the chapter 1 of that book, the term "state-led industrialization" is used to refer to the period that extends from the 1930s to the 1970s, rather than the widely used term "import substitution industrialization", which captures inadequately the development patterns that characterized it.

overstated. The advantages of previous development experience, in terms of productive development upon which new forms of structural transformation could be built, were ignored. The risks involved in the new strategy, widely exposed by critics of the reform effort, were swept aside. Alternative reform agendas, such as ECLAC's "Changing Production Patterns with Social Equity" (ECLAC, 1990), were also given insufficient attention.

As time has proceeded, high expectations led to a significant degree of frustration. The return of moderate rates of economic growth in 1990-1997 generated positive evaluations of the reform effort (see Edwards, 1995; IDB, 1997; and World Bank, 1997), but the new "lost half-decade" of 1998-2002 questioned these early assessments. By the beginning of the XXI century, it is clear that the new development strategy has been effective in generating export dynamism, in attracting foreign direct investment and increasing productivity in leading firms and sectors. In most countries, inflation trends and budget deficits were effectively placed under control, and confidence in the macroeconomic authorities (including independent central banks) increased in most countries. Social spending rose and innovations were introduced in the way social policy was undertaken, with mixed results in the latter case. Increased social spending can also be explained by the democratic wave that was taking place simultaneously in the region. In parallel, and largely unrelated to the reform processes, advances were made in the sustainable development and gender equity agendas.

Nonetheless, these "lights" were mixed with prominent "shadows". Overall economic growth was frustrating and volatile, and domestic savings and investment remained depressed in most countries. Overall productivity performance was poor, largely as a result of a growing underutilization of the available labor force. Increasing productive and labor market dualism became one of the most distinctive effects of the reform process, with the expansion of "world

class" firms (many of them subsidiaries of multinationals) coinciding with growing unemployment and labor market informality. This, together with other factors --technological biases and changes in productive structures that increased the relative demand for skilled labor-- generated adverse effects on an already poor income distribution record, weakening the effects of (in any case, slow) growth on poverty reduction.

There was obviously divergence in the nature of the reforms adopted in different countries. Other factors also influenced outcomes, particularly the social and power structures that go along with a skewed income distribution, lags in building institutions in several areas, and lagged effects of the debt crisis of the 1980s (e.g., the weakening of state apparatuses). Diversity also responded to significant differences among countries in terms of the size, structure and degree of development, geographical position (particularly closeness to the United States market), as well as of the strength or weakness of their economic, political and social institutions.

This paper provides an overall evaluation of the reform process in Latin America. It is based on wide-ranging research undertaken by the United Nations Economic Commission for Latin America and the Caribbean (ECLAC) in recent years, which provides the most comprehensive evaluation of the reform process available.² It is divided in five sections, the first of which is this introduction. Section II takes a look at the characteristics of the reform process. Sections III and IV, which are the core of the paper, analyze in some detail the effects of reforms on economic performance and social trends. Finally, Section V briefly draws some lessons for the future.

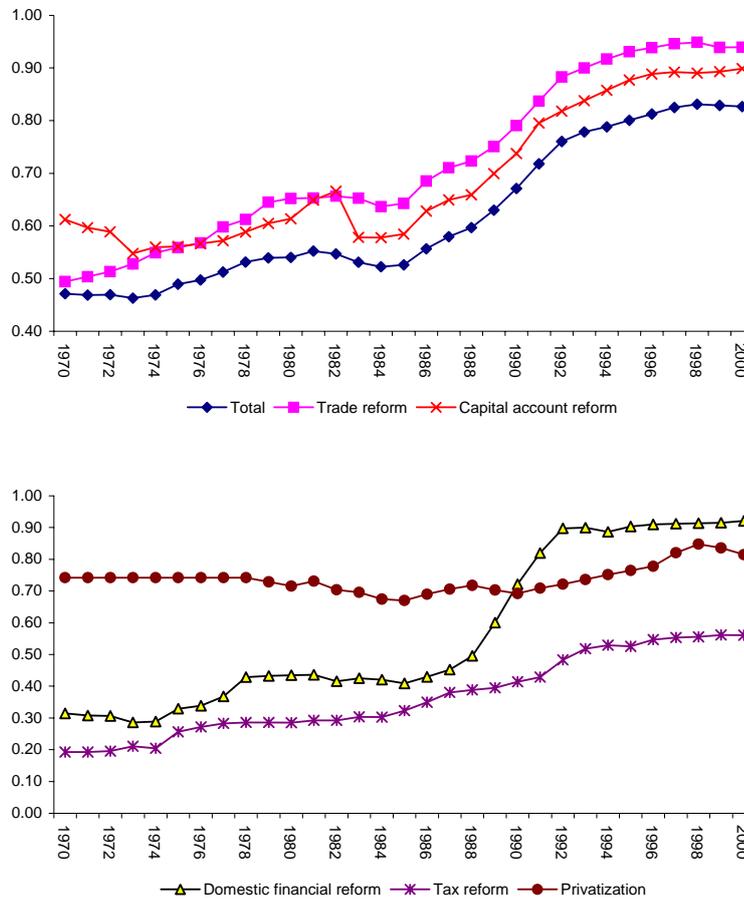
² ECLAC (2003a) provides an overall assessment, which can be complemented with the analysis of social trends in ECLAC (2000a, 2000b and 2001), of issues associated with insertion into the world economy in ECLAC (2002a and 2002b), and of sustainable development patterns in ECLAC/UNEP (2002). The results of a long-term ECLAC project on the impact of structural reform in Latin America and the Caribbean, are summarized in Stallings and Peres (2000), Moguillansky and Bielschowsky (2001), Katz (2001), Morley (2001) and Weller (2001).

II. THE REFORM PROCESS

The implementation of structural reforms aimed at opening up economies to foreign competition and increasing private-sector participation in development began in a few Latin American countries in the 1970s, particularly in the Southern Cone. The debt crises led to some backtracking in the early 1980s, but the process gained significant momentum from the mid-1980s to the mid-1990s, and rapidly extended to the whole region. It tended to level off in the second half of the 1990s, after reaching high levels of liberalization in most countries, with no major reversal during the turbulent macroeconomic events that started in 1998 (Figure 1).³ Indeed, the country with the lowest level of liberalization in 2000 according to ECLAC's index of structural reforms, Venezuela, still stood significantly above the regional average in 1990.

³ This Figure presents the evolution of ECLAC's index of structural reforms (see the methodology in Morley, Machado and Pettinato, 1999). The Inter-American Development Bank has designed an alternative index for 1985-2000 (see Lora, 2001).

Figure 1
Index of structural reforms



Source: ECLAC.

The reform effort was not uniform. Significant liberalization was evident in trade, external capital flows and the domestic financial sector. In the tax area and, particularly, in privatization and labor markets, reforms were less ambitious.⁴ This may look counter-intuitive in the case of privatization, an area in which major efforts were undertaken. However, state companies with large shares in GDP --particularly those operating in the mining and oil sectors but also in electricity, water and, in some cases, telecommunications-- remained state-owned.

⁴ For labor reforms, see Lora (2001), as this is not included in ECLAC's reform index.

Also, in other areas --e.g., development banking-- significant public sector involvement remained in several countries.

Reform strategies differed across the region. Stallings and Peres (2000), who studied nine countries, differentiate between "aggressive" and "cautious" reformers, with Argentina, Bolivia, Chile and Peru in the first category, and Brazil, Costa Rica, Colombia, Jamaica and Mexico in the second. The first group was characterized by encompassing reforms in a short period of time, whereas a more gradual approach and uneven advance in different areas characterized the second. According to this classification, most Latin American countries should probably be classified in the second category. However, even the first group shows major exceptions in some areas (e.g., Chile maintained its state-owned copper and oil companies, as well as a commercial and a development public-sector banks, and widely used capital account regulations through the 1990s).

A significant confusion in the debate has been generated by the tendency to mix structural reforms aimed at reducing the public sector role in the economy and liberalizing market forces, with macroeconomic stabilization policies. Most aggressive reformers introduced liberalization together with major stabilization packages (e.g., Chile in the mid-1970s, Bolivia in the mid-1980s, and Argentina and Peru in the early 1990s), but this pattern is far from universal. The difference is substantial, as macroeconomic balances can be achieved with large differences in the degree of economic liberalization and, conversely, liberalized economies can maintain significant macroeconomic imbalances. Indeed, in several cases, macroeconomic strategies ran counter to the objectives of structural reforms, as they led to overvaluation that affected the expected effects of trade reforms on exports, or to increased taxation to achieve fiscal balance. Furthermore, there is growing evidence that, whereas macroeconomic balances are essential for

growth, links between structural reforms and growth are at best weak (see, in this regard, Rodríguez and Rodrik, 2001). This statement is not inconsistent with the recognition that some structural factors may affect economic growth --e.g., the accumulation of human capital, improved infrastructure, openness and financial depth--, but all of them may be achieved with quite different degrees of public sector involvement. So, these structural factors should not be confused either with structural reforms aimed at liberalization.⁵

III. ECONOMIC PERFORMANCE

1. Macroeconomic performance

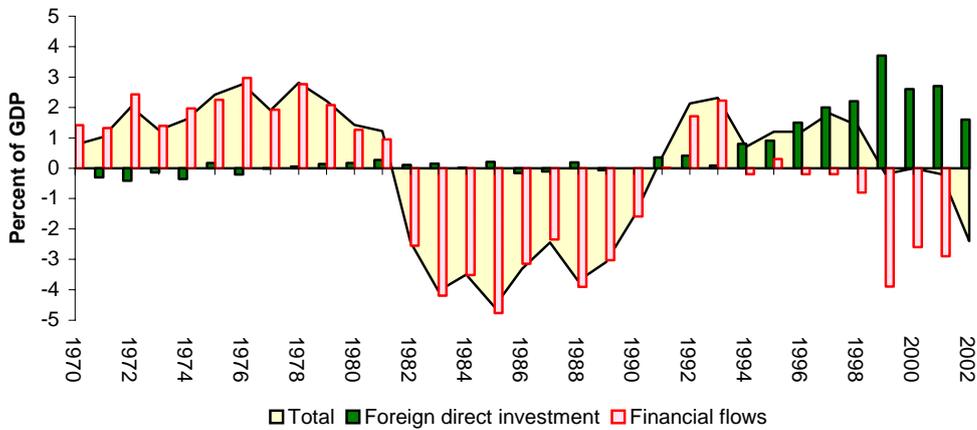
The most salient economic advance in the 1990s was the increasing confidence in the regions' macroeconomic authorities generated by improvements in fiscal conditions and reductions in inflation rates. On average, budget deficits declined significantly in the second half of the 1980s, remained in an average range between 1% and 2% of GDP through most of the 1990s, but increased to levels around 3% since 1999. This was not inconsistent with increased government spending (from a simple average of 16.6% of GDP in 1990 to 20.7% in 2001), as government revenues simultaneously increased. Advance in this area has been uneven across the region, as reflected in the fiscal crises that some countries have experienced in recent years, and the high public-sector debt ratios that characterize several countries. Advance in inflation has been more uniform and permanent. Average inflation in Latin America constantly fell up to 2001, when it reached single digits levels in most countries. Backtracking in 2002, when average inflation increased for a first time in a decade, was concentrated in a few countries, particularly

⁵ This confusion is implicit in the otherwise excellent paper by Loayza, Fajnzylber and Calderon (2002), as these authors find that the accumulation of human capital, public sector infrastructure, effective trade openness and financial depth have positive effects on growth. But all these factors (including openness) can be achieved with different degrees of public sector intervention.

Argentina and Venezuela. In light of the major fiscal imbalances that had characterized the Latin American economies since the late 1970s, the long inflationary history of a number of them, especially in South America, and the hyperinflation that five of them experienced in the 1980s and early 1990s (Argentina, Bolivia, Brazil, Nicaragua and Peru), these achievements are remarkable.

Nonetheless, the expectation that advances in the fiscal area and control of inflation would be reflected in stable access to external capital flows, high investment rates and strong economic growth did not materialize. Renewed access to capital markets was evident in the early 1990s. As Figure 2 indicates, there was a sharp turn from negative to positive net resource transfers through the capital account in the early 1990s. Financial flows played the key role in the early part of this reversal. The most important event in this regard was the development of a dynamic market for Latin American bonds, as a result of structural changes in industrial countries' capital markets, the inducement generated in the early 1990s by low U.S. interest rates, and the 1989 Brady plan, which effectively created a secondary market for Latin American securities. In the second half of the 1990s, foreign direct investment became the leading source of net resource flows. The Asian crisis generated a return to large negative resource transfers through financial flows, indeed in magnitudes similar to those of the 1980s. FDI served as a compensatory factor up to 2001, but its sharp fall in 2002 generated for the first time in more than a decade a large negative overall net resource transfer.

Figure 2
Net resource transfers



Source: ECLAC, on the basis of IMF data.

Renewed growth had characterized only a handful of Latin American economies in the second half of the 1980s (Table 1). Thus, broad-based growth only started in the early 1990s and was, according to some analysts (e.g., IDB, 1997), a positive result of ongoing reform efforts. An alternative explanation, which is consistent with evidence presented below, relies on renewed capital flows. There were certainly links between these two processes: capital flows facilitated structural reforms and exchange-rate-based stabilization policies and, in turn, the boom in external financing was facilitated by reforms (through more liberal capital account regulations and privatization, which induced larger FDI flows, among other channels). However, the broad-based growth deceleration that took place in 1995-1997 and, particularly, 1998-2002 gives a clear prominence to capital flows --and, particularly, to financial flows-- as the determinant of medium-term growth trends in Latin America. Thus, although trade and domestic factors also played a role, fluctuations in the capital account became the major single determinant of the Latin American business cycle since the early 1990s.

Table 1
Recent phases in economic growth, 1985-2002
(Average GDP growth)

	1986-1990	1991-1994	1995-1997	1998-2002
Argentina	0.1	8.0	3.5	-3.3
Bolivia	2.3	4.0	4.7	2.2
Brazil	1.9	2.8	3.3	1.6
Chile	6.4	7.5	7.6	2.3
Colombia	4.8	4.1	3.4	0.4
Costa Rica	4.3	5.5	3.3	4.4
Cuba	-0.7	-9.7	5.1	4.2
Dominican Republic	2.8	4.1	6.7	5.8
Ecuador	1.8	3.7	3.1	0.8
El Salvador	2.1	5.6	4.1	2.7
Guatemala	2.9	4.2	4.1	3.3
Haiti	0.0	-6.0	4.6	0.4
Honduras	3.2	3.4	4.1	2.2
Mexico	1.9	3.5	2.0	3.2
Nicaragua	-3.4	1.0	5.0	4.3
Panama	-0.5	6.4	3.1	2.3
Paraguay	3.9	2.8	2.7	-0.4
Peru	-1.3	5.0	6.0	1.6
Uruguay	3.8	5.6	2.7	-3.1
Venezuela	2.8	3.4	4.3	-1.2

Source: ECLAC

Indeed, this is what the econometric estimates of Table 2 indicate. This table presents panel data estimates for the determinants of economic growth since the mid-1970s, the period characterized by large capital account instability. A very simple model, largely based on external variables, explains close to two thirds of the variance of economic growth, when country specific factors (fixed effects) are taken into account. Financial flows and the growth of imports of industrialized countries exercised the strongest effects on growth performance, but the impact of the first of these factors is twice as strong if the variance of the explanatory variable is taken into account. According to these results, the terms of trade and foreign direct investment did not exercise a statistically significant effect on growth. On the other hand, the ability to avoid high inflation (over 40% a year) also had a strong effect, but moderate inflation --and thus its

reduction to one digit levels-- did not exercise a significant effect. On the other hand, the trajectories of the reform process, as measured by ECLAC's index of reforms, did not exercise a statistically significant effect on comparative growth performance. This result is consistent with other analyses of the effects of structural reforms on economic growth (see below).

Table 2
Determinants of GDP growth

	Coefficient (t-statistic)	Coefficient (t-statistic)	Coefficient (t-statistic)	Coefficient (t-statistic)	Mean (standard deviation)	
Constant	0.0219 (1.06)	0.0223 (2.21)	Fixed effects	Fixed effects	0.0290 -(0.0270)	a/ a/
Inflation (log)						
Bounded at 40%	-0.0110 -(0.47)		0.0195 (0.74)		0.1864 (0.1094)	
Excess over 40%	-0.0114 -(2.48)	-0.0110 -(2.63)	-0.0127 -(2.52)	-0.0097 -(2.02)	0.1668 (0.5011)	
Net resource transfers (% of GDP)						
Foreign direct investment	-0.5963 -(1.54)		-0.7972 -(1.89)		0.0054 (0.0103)	
Financial flows	0.5932 (5.70)	0.6321 (6.28)	0.5940 (6.03)	0.6379 (6.69)	-0.0051 (0.0247)	
Terms of trade (index)	-0.0083 -(0.88)		0.0005 (0.04)		1.0306 (0.2369)	
Average growth of developed countries' imports	0.1217 (2.87)	0.1099 (2.61)	0.1250 (3.15)	0.1089 (2.75)	0.0343 (0.0558)	
Total reform index						
Initial value	0.0427 (1.66)	0.1022 (0.90)	0.0741 (2.46)	0.0210 (1.41)	0.6294 (0.1508)	
Annual absolute change	0.0982 (0.81)	0.0183 (1.25)	0.1189 (1.00)	0.1080 (1.00)	0.0128 (0.0201)	
R ²	0.5228	0.5013	0.6598	0.6330		

a/ Mean and standard deviation of dependent variable.

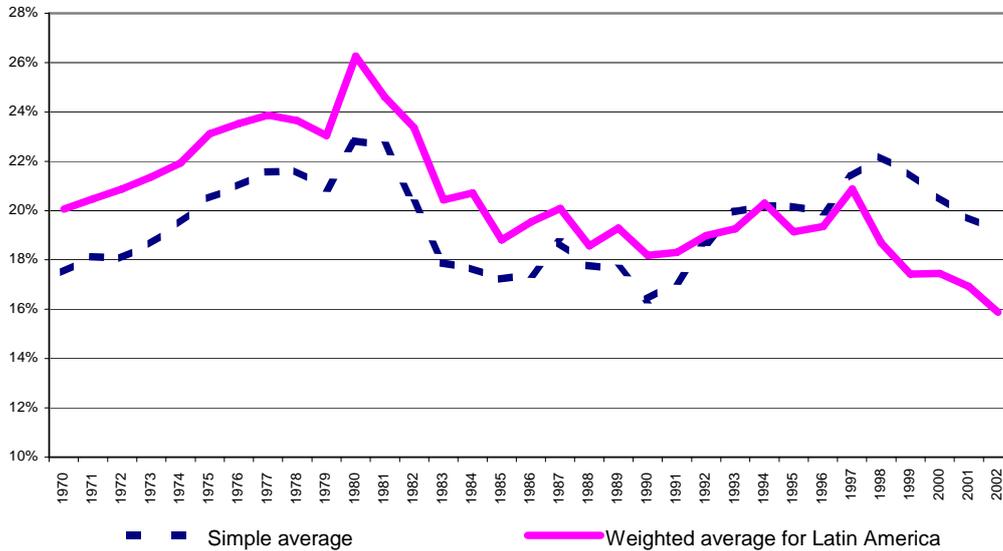
Note: Panel data estimates for all Latin American countries for the periods 1976-1980, 1981-1985, 1986-1990, 1991-1994, 1995-1997, 1998-2002, based on ECLAC data.

Macroeconomic policy management has been partly responsible for the sensitivity of economic growth to capital flows, the propensity to domestic financial crises, and for some features of the process of productive restructuring. This reflects tensions between macroeconomic policies and reform objectives. In particular, the strong bias in favor of currency appreciation that characterized the periods of abundance of external financing was partly

responsible for the adjustment problems faced by tradable sectors in several countries, as well as for the speculative attacks and the increased risks of domestic financial crises when there was a sudden stop in capital flows. Also, the tendency to adopt pro-cyclical fiscal and, particularly, monetary and credit policies, which foster lending booms and drops in interest rates during periods of expansion, as well as marked monetary contraction and high interest rates during crises, has been an underlying cause of unstable economic growth and national financial crises. About half of Latin American countries experienced domestic financial crises during the 1990s, absorbing considerable fiscal and quasi-fiscal resources and affecting the very functioning of financial systems, sometimes for extended periods of time (ECLAC, 2002b, and 2003a, chapter 3; Ffrench-Davis, 2003; Ocampo, 2002b).

Dependence on external financing was closely associated to some features of productive restructuring, which generated a structural deterioration in the trade balance/growth trade off (see below) and a high sensitivity of the trade balance to economic activity. The tendency to substitute foreign for domestic saving, which characterizes periods of intense capital inflows, played a similar role. More broadly, domestic savings remained depressed in the 1990s, making investment highly dependent at the margin on external savings. Investment rates experience a partial recovery, particularly if the simple rather than the weighted average is considered, but this was cut short by the interruption of capital flows since the Asian crisis (see Figure 3).

Figure 3
Fixed Investment as a percentage of GDP
 (estimated at 1995 prices)



Source: ECLAC.

Overall, long-term growth has been frustrating. For the period 1990-2002 as a whole, the average growth rate, of only 2.6% a year or 1.0% per capita, was less than half the level experienced by Latin America between 1945 and 1980, namely 5.5% per year or 2.7% per capita. The comparison of total rather than per-capita growth rates is more appropriate, as the demographic transition adversely affected per-capita trends in the period of state-led industrialization, while the opposite was true in the 1990s, when the region benefited from a “demographic bonus” (see Section IV.1 below). This is reflected in the fact that the labor force grew in the 1990s at rates quite similar to those that characterized the 1945-1980 period. Moreover, the slowdown in long-term growth rates vis-à-vis 1945-1980 was a feature of most Latin American countries, the only major exceptions being Chile (which combined a poor record in 1945-1980 with rapid growth in 1990-2002, particularly up to 1998) and the

Dominican Republic (which grew rapidly in both periods). As we will see below, overall productivity performance was equally poor.

2. Integration into the world economy

Dynamic export growth and foreign direct investment are the clearest signs of the significant progress made by the Latin American countries in their integration into the world economy. From 1990 to 2000, the region posted the fastest growth of export volumes in its history --close to 9% per year--, higher than the rate achieved by world trade as a whole; the recent world slowdown temporarily interrupted this trend. The strong growth of Mexican exports explains much of this strength. Indeed, since the late 1990s, Mexico has concentrated nearly half of Latin America's exports of goods. On the other hand, Brazil experienced export growth below the regional average and its own historical performance since the 1960s; nonetheless, contrary to the regional trend, Brazilian real export growth speeded up in recent years. Most other countries experienced healthy real export growth of goods in the 1990s, close to 8% a year on average.

Export diversification progressed at very different speeds in different countries and sub-regions. The most salient development was the rapid change in the composition of Mexican exports, though great diversification also took place in several Central American countries and in the Dominican Republic (Table 3). In the case of Mexico, there was a broad-based boom in manufacturing exports to the United States covering a wide range of products, including those resulting from in-bond assembly (maquila) activities. In the smaller countries, the diversification was more closely related to the development of assembly industries, again geared towards the United States market. Given the increased weight of assembly products in these countries, both the rate of growth and the degree of diversification of exports would be less pronounced if they were estimated in terms of value added (which is generally very small --see ECLAC, 2003b,

chapter III). The change in the composition of exports was slower in Brazil, which also has a highly diversified export structure, and, particularly, in the rest of South America, where primary products and natural-resource-intensive manufactures --many of them also capital-intensive-- still account for a large share of exports. Also contrary to the pattern of Mexico and Central America, South American exports are less dependent on the United States market.

Table 3
Composition of Latin American exports
(Percentages of exports)

Countries / Regions	Primary products		Manufactures based on natural resources		Manufactures with low level of technology		Manufactures with middle level of technology		Manufactures with high level of technology		Non classified products	
	1990	2000	1990	2000	1990	2000	1990	2000	1990	2000	1990	2000
Latin America and the Caribbean	39.3	27.3	22.6	17.0	11.5	14.0	18.7	24.6	5.7	14.0	2.2	3.1
Mexico	29.4	11.7	9.4	5.8	10.6	14.7	31.8	38.5	14.9	25.3	3.9	3.9
Mercosur	36.5	34.7	23.6	24.1	14.8	11.0	20.7	21.2	3.2	6.6	1.1	2.4
Argentina	45.5	49.8	27.0	21.9	11.9	8.5	12.4	16.2	2.3	2.4	0.9	1.2
Brazil	32.0	27.1	23.3	25.5	14.9	11.6	24.9	24.3	3.8	8.9	1.1	2.5
Paraguay	78.0	57.4	12.8	14.5	6.6	8.7	1.8	0.8	0.1	0.7	0.7	17.9
Uruguay	36.4	36.7	14.3	20.5	36.1	22.0	8.4	13.6	1.2	2.8	3.6	4.4
Andean Community	58.1	59.5	30.0	24.5	5.6	6.3	4.4	6.4	0.3	0.9	1.5	2.4
Bolivia	61.7	56.0	21.2	24.7	6.4	13.4	1.0	1.1	0.3	1.0	9.3	3.8
Colombia	67.3	59.4	14.5	13.2	8.2	10.4	6.8	10.4	0.5	2.0	2.7	4.5
Ecuador	87.7	76.1	9.1	15.4	1.3	3.4	1.0	2.9	0.4	0.9	0.5	1.3
Peru	43.1	41.8	38.7	35.6	12.7	14.5	3.1	2.4	0.3	0.5	2.1	5.1
Venezuela	51.0	59.9	40.1	30.1	3.4	2.6	4.6	6.2	0.2	0.4	0.6	0.7
Central America												
Common Market	57.9	27.7	11.1	9.2	21.0	39.7	5.4	6.6	3.4	14.5	1.2	2.2
Costa Rica	56.9	29.1	7.0	8.5	25.5	17.1	6.1	8.3	3.5	34.3	1.0	2.8
El Salvador	46.4	13.4	11.4	9.8	24.9	62.7	8.2	5.9	8.2	6.4	0.9	1.8
Guatemala	53.0	36.1	16.9	12.4	20.5	39.9	5.0	7.4	3.6	2.5	1.0	1.7
Honduras	70.2	21.4	9.4	6.4	16.0	65.2	2.7	4.1	0.6	1.3	1.0	1.6
Nicaragua	70.9	46.9	15.1	8.8	3.9	36.7	4.6	2.5	0.9	0.3	4.5	4.7
Caricom	41.0	37.4	26.4	34.9	10.1	10.2	18.2	11.6	1.8	1.4	2.5	4.6
Others												
Chile	41.9	40.3	49.4	48.6	2.4	3.0	3.5	5.7	0.3	0.7	2.4	1.7
Cuba	25.6	22.2	65.5	69.2	1.9	1.7	1.2	3.5	4.7	1.7	1.2	1.6
Haiti	11.0	8.9	4.3	2.9	67.0	85.2	8.4	1.0	6.3	0.3	2.9	1.6
Cayman Islands	40.5	2.3	18.6	7.0	3.3	1.0	26.2	85.3	1.1	2.6	10.3	1.9
Panama	28.8	24.9	13.4	14.3	10.0	18.1	38.5	26.7	5.9	12.0	3.4	3.9
Dominican Republic	12.7	4.9	11.6	8.6	49.6	62.7	18.5	17.5	1.6	3.5	6.0	2.9
Memo:												
Republic of Korea	3.2	1.7	7.4	12.0	41.7	16.9	25.9	29.2	20.5	38.4	1.3	1.8
China	14.6	4.7	8.2	6.9	53.6	47.6	15.4	17.3	7.3	22.4	0.8	1.1
Taiwan, Province of China	4.4	1.3	6.7	4.8	38.8	21.8	25.2	25.0	23.8	45.5	1.1	1.5

Source: ECLAC.

An important element in the expansion and diversification of exports was the significant progress of intra-regional trade associated with the strengthening of long-standing economic integration and free trade agreements, and the creation of new ones. Between 1990 and 1997, trade growth within the two major South American integration processes, the Southern Common Market (Mercosur) and the Andean Community, was very rapid (26% and 23% per year, respectively). It was slower but still dynamic in the Central American Common Market (17% a year). A salient historical feature of intra-regional trade in Latin America, the weight of a diversified mix of non-traditional manufactures, continued to characterize this process. In fact, if such trade were excluded, the heavy concentration of South American exports on commodities would be even more apparent. The expansion of trade within the two South-American integration blocks was sharply interrupted in 1998, giving way to strong fluctuations in intra-regional trade and to a weakening commitment to regional integration.

Thus, Latin America has been generating two basic patterns of specialization, which approximately follows a regional “North-South” divide. The “Northern” pattern is characterized by manufacturing exports with a high content of imported inputs (in its extreme form, *maquila*), mainly geared towards the United States market. This pattern goes hand in hand with traditional agricultural exports and agricultural export diversification in Central America, and the growth of tourism in Mexico and the Caribbean. The “Southern” pattern is characterized by the combination of extra-regional exports of commodities and natural-resource-intensive manufactures and a diversified intra-regional trade; as indicated, many of these goods are also capital-intensive. In the case of Brazil, it is mixed with some technology-intensive manufactures and services, and in Brazil and a number of other countries, with labor-intensive manufacturing exports. This implies that Mexico and some Central American and Caribbean countries have

shared to a greater extent in the more dynamic world markets for manufactures, whereas South America has focused on the less dynamic commodity markets. Nonetheless, a more detailed breakdown indicates that most Latin American countries specialize in goods that are not dynamic in world trade (ECLAC, 2002a and 2002c). There is also a third pattern of specialization, which is found in Panama and some small economies in the Caribbean Basin, in which service exports (financial, tourism and transport services) predominate. As we will see in the following section, specialization patterns have affected production patterns, particularly the dynamism of manufacturing production.

The boom in foreign direct investment was generated by both global and regional factors. Among the latter, we should include privatization, deregulation of natural-resource-intensive sectors, free trade agreements and preferential arrangements granted by more industrialized countries or regions (particularly the North American Free Trade Agreement and the Caribbean Basin Initiative) and restructuring of productive sectors in the framework of the regional integration process. Trade specialization and foreign direct investment patterns have been closely linked. Thus, whereas the “Northern” specialization pattern has attracted multinationals actively involved in international integrated production systems, investment in services, natural resources and production for regional integration processes is more prevalent in South America.

FDI has included a large share of mergers and acquisitions of existing assets, first through participation in privatization processes and, more recently, in private mergers. In the late 1990s, it is estimated that mergers and acquisitions represented around two fifths of FDI in the region. A corollary of this process has been a rapid increase in the participation of foreign firms in production and sales, at the cost of public sector firms in the first half of the 1990s, and of both

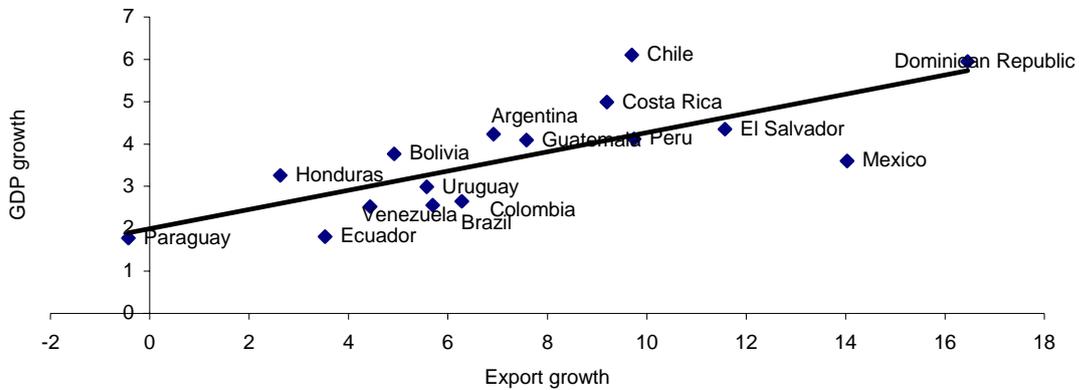
public and private firms in the second half.⁶ A parallel development, smaller in magnitude, has been intra-regional direct investment, which has included mergers and acquisitions and a wave of strategic alliances between large domestic firms, in some cases as part of a transition towards sub-regional or regional multinational corporations.

The contrast between the dynamic internationalization of the Latin American economies and the weak GDP performance analyzed in the previous section is, undoubtedly, one of the paradoxical effects of structural reforms in the region. It reflects a strong weakening of the links between international trade and domestic production (and, thus, GDP). It is a reflection of a reduction in the domestic productive and technological linkages of export sectors, as well as the simultaneous destruction of the production linkages generated by previous import-substitution sectors unable to reconvert into export activities, or able to do so only through increased imports of intermediate goods and services. All these processes have been particularly intensive in manufacturing activities. Outsourcing by multinational firms, even in non-tradable sectors (e.g., services) has further contributed to the weakening of their domestic linkages. In a very significant sense, many internationalized sectors have an increasing "enclave" component: they participate actively in international transaction but only weakly in the generation of domestic value added. Indeed, the natural-resource intensive sectors of the "Southern" pattern of specialization may provide more opportunities for domestic productive and technological linkages than the assembly activities characteristic of the "Northern" pattern (see ECLAC, 2003b, chapter III, and World Bank, 2002).

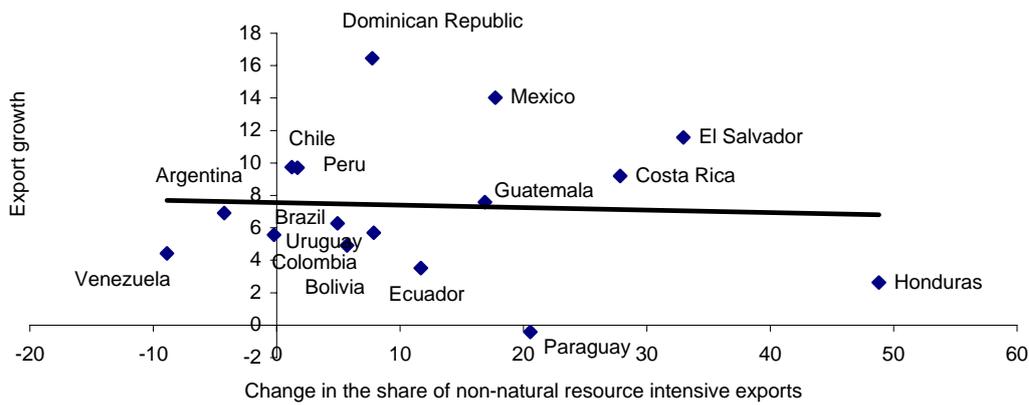
⁶ According to ECLAC estimates, involving the sales of the largest thousand firms operating in the region, the share of foreign firms increased from 29.9% in 1990-1992 to 35.5% in 1994-1996 and 41.6% in 1998-2000. The share of domestic private firms increased from 37.7% to 42.7% during the first half of the decade, but then fell to 41.3%. That of public-sector firms fell continuously, from 32.5 to 17.1%.

Figure 4
Specialization patterns, export and GDP growth, 1990-2000

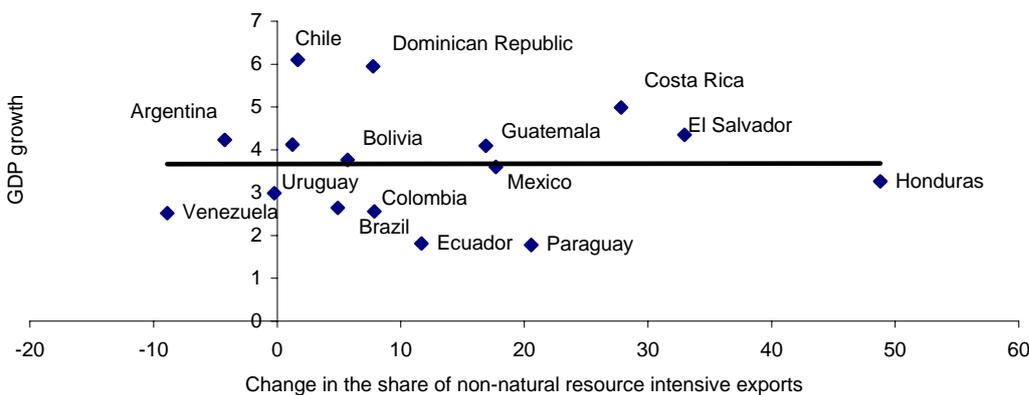
A. Export and GDP growth



B. Change in the share of non-natural resource intensive exports and export growth



C. Change in the share of non-natural resource intensive exports and GDP growth

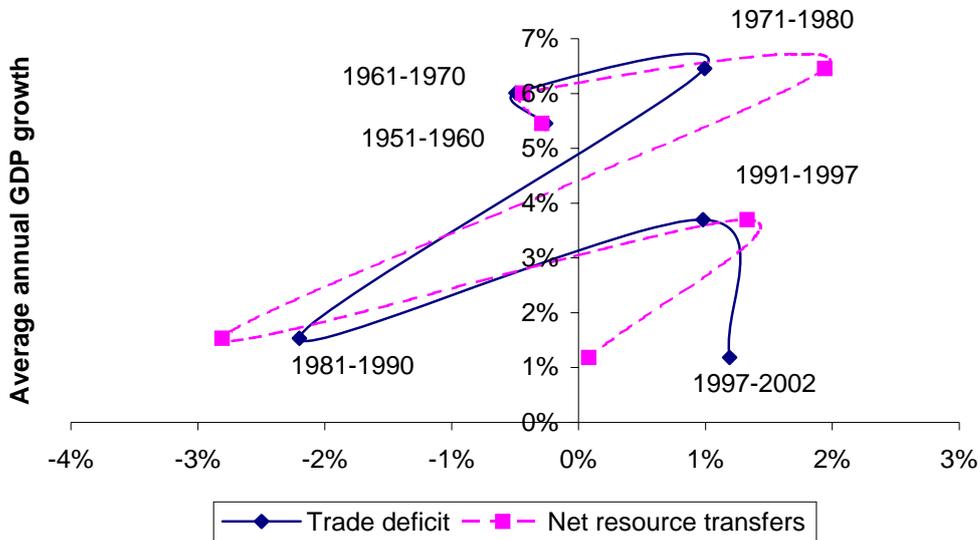


Source: ECLAC.

Interestingly, as Figure 4 indicates, despite the weaker linkages of internationalized sectors, there has been a strong cross-section correlation between export and GDP growth in Latin America. This correlation, together with the fact that rapid export growth did not lead to rapid GDP growth for the region as a whole, is closely associated to a third pattern, which is also regional in scope: the deterioration in the growth/trade deficit tradeoff, which was reflected in an even more rapid growth of imports than that experienced by exports.⁷ The trade deficit tended to widen in 1991-1997, reaching levels comparable to those of the 1970s, but at growth rates that were close to three percentage points below those registered in that decade (see Figure 5). This was the joint effect of structural changes in productive structures brought about by economic liberalization --including weaker linkages of internationalized sectors-- and the short-term macroeconomic policy bias towards real appreciation generated by booming capital inflows. High dependence on volatile external financing was, in this regard, an effect but also a cause of this deterioration. Interestingly, this worsening of the growth/trade deficit tradeoff is even worse if the point of reference is the 1950s and 1960s, when rapid growth was consistent with small trade surpluses. This process further worsened during the recent "lost half-decade", 1998-2002, when the trade deficit remain stubbornly high despite very slow economic growth; indeed, the relevant point of reference is in this case the 1980s, when Latin America also grew very slowly but generated a high trade surplus.

⁷ See a similar analysis in UNCTAD (1999), which shows that this deterioration has occurred throughout the developing world, except in China and some other Asian economies.

Figure 5
Trade balance/growth tradeoff



Source: ECLAC.

It must be emphasized that, although there is a strong correlation between export and GDP growth, neither export nor overall GDP growth have been associated to specialization patterns. Chile is the outstanding example of a country specializing in natural-resource intensive exports that has also experienced rapid export and GDP growth. Ecuador and Venezuela are opposite cases. Mexico has extracted relatively slow GDP growth out of an outstanding export diversification and growth. In this regard, Costa Rica and El Salvador but, particularly, the Dominican Republic have done better. As it was indicated, the high import content of manufacturing exports and the tendency to specialize in the technologically simpler task in international integrated production systems may, indeed, result in natural resource intensive exports generating more domestic value added and linkages than manufacturing exports.

If specialization patterns are not part of the explanation, does the scope of reforms provide the clue to diverging GDP performance? Evidence coming from ECLAC research

indicates that links between reforms and growth have been at best weak: some reforms had positive but others negative effects on growth, which in the net balance out to an statistically insignificant overall effect; furthermore, even if their long-term effect was neutral or positive, its short-term impact was clearly negative (Escaith and Morley, 2001).⁸ These results are consistent with parallel research on this link⁹ and with the econometric estimates presented in the previous section. In any case, the best indication of the unclear effects of reforms on growth comes from the evaluation of macroeconomic trends since 1990s vis-à-vis dynamic growth during the period of state-led industrialization.

3. Changing production patterns

The sluggishness of the region's average economic growth is a sign of macroeconomic, sectorial and microeconomic problems. As noted in the previous section, at the aggregate level, it reflects a worsening of the relationship between economic growth and the external accounts, and the inadequate recovery of investment ratios. At the sectorial level, it is the result of the weak productive and technological linkages of internationalized activities. At the microeconomic level, it reflects the tendency of businesses to adopt "defensive" strategies (i.e., low-investment organizational, productive restructuring, and marketing strategies) as they try to adjust to the new context, rather than "offensive" strategies (combining earlier restructuring

⁸ See also the recent sensitivity analysis of Correa (2002).

⁹ This is particularly true when the results of Lora and Barrera (1998) are compared with those of Lora and Panizza (2002), which used in both cases the Inter-American Development Bank reform indexes. Whereas the earlier paper estimated strong effects of reforms on growth, the latter only calculated weak temporary effects. Furthermore, a close inspection of the tables of this recent paper indicates that this conclusion is not robust. Although Loayza, Fajnzylber and Calderon (2002) claim that reforms had significant effects on long-term growth, they measure the effects of some long-term factors rather than reforms (see Section II.1 and footnote 5). Particularly, their results indicate strong long-term effects of human capital accumulation and infrastructure on economic growth. They also show somewhat weaker effects of effective trade openness and financial depth, but do not estimate those of trade and domestic financial reforms.

efforts with substantial increases in investment in new equipment and technology, as well as with different strategic alliances).

At the sectorial level, some additional stylized facts may also be discerned.¹⁰ A paradoxical effect of policies aimed at deeper integration into the world economy was the relative dynamism of non-tradable vs. tradable sectors in many countries. Transport, communications, energy and financial services, as well as construction, were indeed dynamic, particularly during the expansionary phases of the regional business cycle. Among tradable sectors, manufacturing suffered, in general, most in comparison with its own historical record prior to the debt crisis. This was especially true in the more traditional, labor-intensive industries (apparel, footwear and leather manufactures, furniture, etc.), with the exception, in the latter case, of those industries associated with in-bond assembly (maquila) activities. The manufacturing sectors that performed better include maquila activities, the automobile industry (which is favored, in Mexico, by access to the United States market and, in South America, by special protection mechanisms provided by current integration arrangements), some natural-resource-processing industries, and certain activities geared towards the domestic market during periods of booming demand (such as construction materials, beverages and food processing).

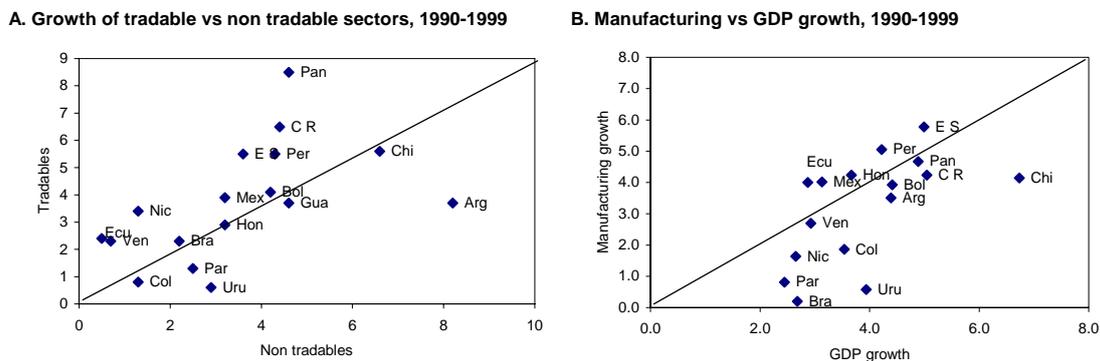
Agriculture also grew more slowly than it did before the debt crisis, with significant divergence in performance across the region. Moreover, some of the most dynamic activities in this sector followed long-term trends (e.g., the strong relative performance of soybeans or poultry production) unrelated to the reform process. Mining has tended to grow rapidly, but extraction activities have grown more than those generating a greater value added (refining).

¹⁰ See ECLAC (2003a), chapters 4 and 5, Stallings and Peres (2000), Katz (2001), Moguillansky and Bielschowsky (2001) and, for agriculture, David (2000) and Ocampo (2000).

Mining, like telecommunications and, to a lesser extent, energy, have benefited from institutional changes designed to open up opportunities for greater private-sector participation and foreign direct investment. In the case of mining resources, as well as FDI and intellectual property, an important feature of reforms was stronger protection of property rights.

As Figure 6 shows, the mix between the growth of tradable and non-tradable sectors was diverse across the region through the 1990s, and did not follow the Northern-Southern divide that characterized trade specialization patterns --although, as we will see below, employment trends did follow them. The association between specialization patterns and the relative dynamism of manufacturing was, on the contrary, quite strong. Economies specializing in manufacturing exports were characterized by a rapid relative growth of manufacturing production, while the opposite was true of economies that specialized in natural resource-intensive exports. It is interesting to recall that the rising share of manufactures in GDP was a universal feature of Latin American countries during the period of state-led industrialization. During the reform period, it characterized only economies with a strong manufacturing export bias.

Figure 6
Patterns of Structural Transformation



Source: ECLAC

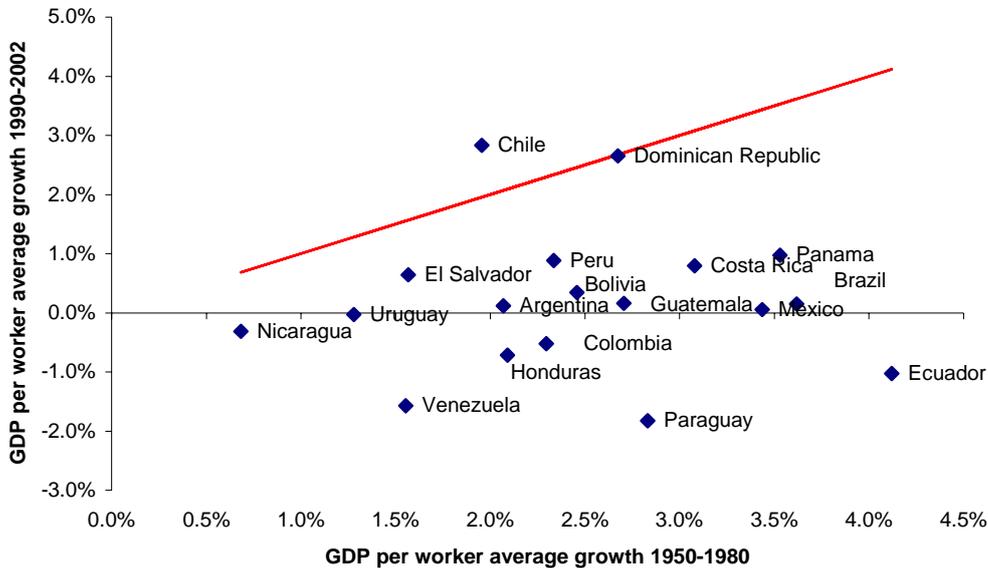
Slow GDP growth was associated with poor productivity performance, but the causal links involved must be carefully drawn. Even in manufacturing sectors, where productivity rose, the gap with the industrialized economies, particularly the United States, actually widened in many sectors in the 1990s. Indeed, in many countries and manufacturing activities, the productivity gap in relation to the United States narrowed more quickly during the 1970s and the 1980s than during the 1990s, reflecting in part the slower pace of technological change in United States manufacturing during those previous decades. At the sub-sectoral level, the closing of the technology gap had more to do with the pace of economic growth of a particular sector and country than with patterns of technological catch up induced by the reform process (Katz, 2001). Thus, for example, automobile production, for which selective instruments of protection were maintained, experienced productivity increases as dynamic as the natural resource-intensive export activities, whereas import competing sectors displaced by external competition did poorly in terms of productivity performance. Thus, the corresponding dynamics followed a Kaldor-Verdoorn pattern, in which growth determines productivity, rather than the opposite neo-classical causal link.

Agriculture also experienced a sustained increase in productivity, but this is a long-term trend which did not speed up to any significant extent during the 1990s (Dirven, 1997; Ocampo, 2000). Telecommunications, mining and, in some cases, energy are perhaps the sectors that most clearly demonstrate increases in productivity in the 1990s associated to the reform process as such, particularly privatizations and the growing role of multinational enterprises (ECLAC, 2003a, chapters 4 and 5; Stallings and Peres, 2000).

In more general terms, productivity trends reflect a large discrepancy between the positive evolution of this variable in a group of successful firms and sectors and its poor

performance at the aggregate level. Total factor productivity (TFP) slowed down relative to its pre-debt crisis pace, even if recent years of low growth are excluded from calculations: 1.7% a year in 1990-1998 vs. 2.0% in the age of state-led industrialization, or 0.8 vs. 1.0% for double-augmented TFP (Hofman, 2001). The slowdown was sharper for labor productivity, as the estimates of the productivity of labor force in Figure 7 indicate. Except for Chile, the Dominican Republic and Uruguay, average labor productivity --measured as the ratio of GDP to the labor force-- rose less in the region in 1990-2001 than in 1950-1980 (Figure 7). Growing unemployment and, particularly, underemployment, largely due to poor overall economic growth, drove aggregate labor productivity. More broadly, overall productivity performance reflects the fact that labor, capital, technological capacity and, sometimes, land, displaced from sectors and firms undergoing productive restructuring were not adequately reallocated to dynamic sectors. Again, the corresponding patterns followed a Kaldor-Verdoorn --e.g., slow growth led to poor productivity performance-- rather than the opposite neo-classical dynamics.

Figure 7
Labour force productivity



Source: ECLAC. Productivity is estimated on the total labor force. It thus differs from traditional estimations of labor (and total factor) productivity, which take into account the employed labor force only.

These patterns of productivity performance brings to light one of the main features of the productive restructuring processes that characterized the region during the reform period: the increased diversity of productive sectors and agents within each economy --i.e. increasing dualism (or "structural heterogeneity", using the traditional ECLAC concept). This indicates that the expectations that rising productivity in internationalized sectors would spread throughout the economy, leading to rapid overall economic growth, turned out to be quite elusive. Productivity did increase in dynamic firms and sectors, and external competition, FDI and privatization played an important role in that process. However, contrary to the expectations of reformers, and the neo-classical links on which those expectations were based, positive productivity shocks did not spread out, but rather led to greater dispersion in relative productivity levels within the economies.

This is also an indication of the fact that restructuring was not "neutral" in terms of its impact on different economic agents. The major winners were the multinational corporations and large national firms in sectors with static comparative advantage, but domestic firms in import substitution sectors and, particularly, many small and medium-sized enterprises, both urban and rural, were unable to compete and experienced high mortality rates. The performance of small firms was closely tied to the dynamism of the sectors where they have high shares in production.¹¹

4. The changing institutional framework

Many of the changes in public policy that occurred during the reform period were aimed at redrawing of the boundaries between public and private activity. The countries of the region faced the challenge of modernizing their public-sector institutions, in terms both of their size and of the rules of the game (policies, legal norms and patterns of behavior). Both aspects proved to be crucial once the reforms began to mature. As evidenced by the experience of several countries, some of the institutional changes that were put in place (including the development of an adequate supervisory and regulatory framework in the domestic financial sector) played a crucial role in determining the balance benefits and costs involved in the move towards economic liberalization.

Although this is a field in which most countries of the region still have a long way to go, progress has been made in some areas. At the macroeconomic level, a wide variety of discretionary oversight powers were replaced by a few general rules that are more "market-friendly" but also more stringent as far as compliance is concerned. By the same token, the

¹¹ See an extensive analysis of the issue of winners and losers in ECLAC (2003a), Stallings and Peres (2000) and Peres (1998), and of the dynamics of small firms in Peres and Stumpo (2000).

distribution of functions (e.g., between fiscal and monetary authorities) was more clearly defined, thus making it possible to establish mutual accountability. In general, as we have seen, the changes introduced strengthened the confidence of economic agents in macroeconomic authorities.

Other institutional and organizational changes originated in sectors in which new modalities of public and private operation played a key role. One of these was infrastructure services (particularly telecommunications, energy and transportation), in which public action was increasingly geared towards promoting private investment and competition and, as a complement to this, controlling the distortionary effects of monopolies. As a result of these efforts, new institutional capacities were developed for promoting competition, regulating specific markets and, to a lesser extent, protecting consumers. Parallel to this, the tasks that had formerly been melded in the operation of State-owned monopolies were split, thus separating policy design from regulatory functions and service provision, even when the latter remained in State hands. Similar changes took place in the design of social policy (education, health, pensions and housing). In some cases, innovative schemes were developed for financing the services in question.

Although the institutions involved in all these areas have learned a great deal from the process, the results achieved were modest compared with the magnitude of the challenge involved, and there is still an active institutional learning process in place. Such lags had significant economic effects. Thus, the more competitive climate and the opening up of opportunities for the private sector led to progress in terms of market efficiency and contestability, with potential benefits for consumers and resource allocation. However, growing economic concentration created pressure in the opposite direction, even in tradable

sectors. This tension had complex effects in infrastructure sectors, particularly when openness to private investment was not explicitly aimed at increasing competition or even led to the replacement (at least temporarily) of public monopolies by private ones and, more broadly, when the development of regulatory regimes lagged behind. Furthermore, where privatization processes were badly designed, with no prior regulation in place, the process gave rise to massive transfers of wealth. In social service delivery, other types of problems were involved (see below).

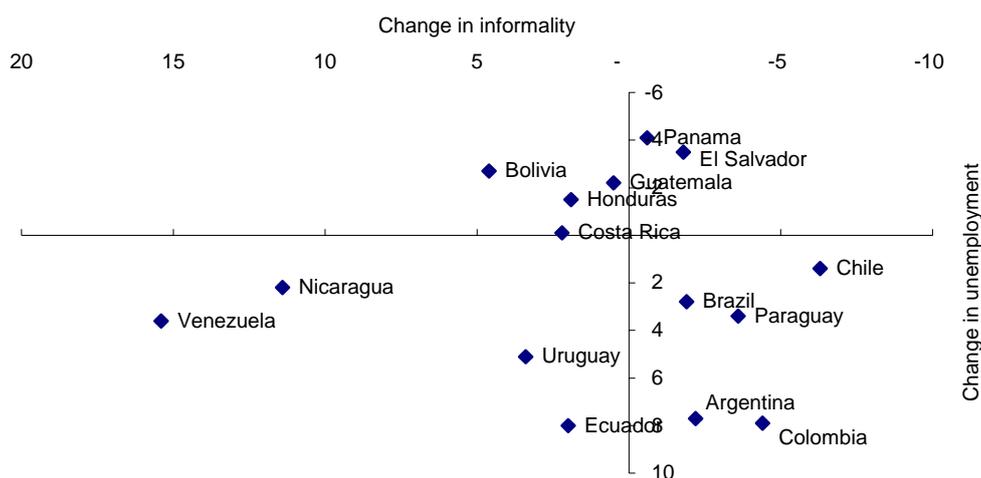
IV. FRAGILITY OF SOCIAL TRENDS

1. Weakness of labor markets

The growing dualism among economic agents and sectors that characterized Latin America during the reform period has been particularly reflected in the performance of labor markets (ILO, 1999; ECLAC, 2002a, chapter. 10; Weller, 2001). Despite faster growth in relation to the “lost decade” of the 1980s, open unemployment rose by almost three percentage points during the 1990s and shot up in some countries, particularly during major external shocks. Indicators of deterioration in job quality are even more widespread, as shown by the relative increase in employment in low-productivity sectors. Urban informality rose from 43.0 to 48.4%, generating seven out of ten new jobs between 1990 and 1999. This deterioration is also evident in the relative increase in temporary employment, in reduced coverage of social security systems, particularly in workers of small enterprises, and even in the number of individuals working without a written labor contract --the utmost reflection of inadequate protection (Tokman and Martínez, 1999; ECLAC, 2002a, chapter 10).

The mix between unemployment and informality depended, among other factors, on the patterns of economic growth, labor market policies, and international labor migration. In any case, most countries experienced a deterioration in either one of these dimensions or in both of them, indicating that these two mechanisms were complementary in terms of labor market adjustment (Figure 8). One specific factor that played a significant role in labor markets was the pattern of international specialization (ECLAC, 2002a, chapter 10; Stallings and Weller, 2002). As Table 4 indicates, the “Northern” pattern of specialization in manufactures (and some services) proved much more effective in generating employment, particularly wage labor employment in tradable sectors, than “Southern” specialization in natural resource intensive goods. As employment in non-tradable sectors did not follow specialization patterns (particularly in relation to wage employment), whereas that in tradable sectors did, the growth of employment was more dynamic in the Northern part of the region.

Figure 8
Variable mixtures of unemployment and labor informality, 1990-2000



Source: ECLAC

Table 4
Patterns of employment generation
(Annual average growth rates)

	Total employment			Wage earner employment		
	Total	Tradable sectors a/	Non tradable sectors b/	Total	Tradable sectors a/	Non tradables sector b/
Simple average						
Mexico and Central America	3.6	2.1 (3.9)	4.8 (3.1)	3.6	3.1 (4.4)	3.7 (2.9)
South America	2.6	1.3 (1.3)	3.1 (2.5)	2.5	1.0 (0.8)	3.1 (2.6)
Total	3.0	1.7 (2.5)	3.9 (2.7)	3.0	1.9 (2.4)	3.3 (2.7)
Weighted average						
Mexico and Central America	3.2	1.8 (4.1)	4.1 (4.3)	2.8	2.0 (3.6)	2.7 (3.6)
South America	1.8	0.2 (0.2)	2.6 (2.5)	1.8	0.1 (-0.1)	2.5 (2.6)
Total	2.2	0.8 (1.5)	3.0 (2.9)	2.1	0.7 (0.9)	2.6 (2.9)

Source: ECLAC, on the basis of special tabulations of household surveys.

a/ The data between parenthesis corresponds to manufacturing sector.

b/ The data between parenthesis corresponds to government, social, community and personal services.

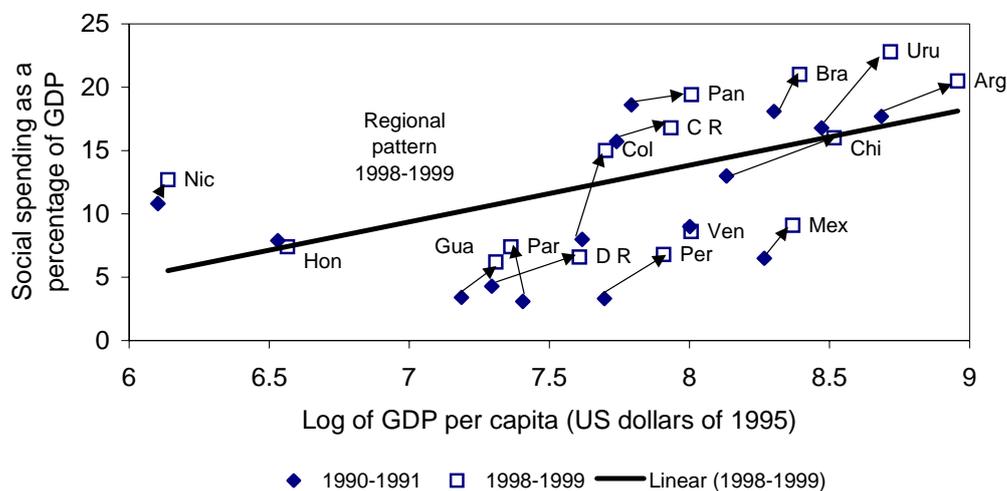
Weak job creation and its concentration in low-productivity activities, indicate that Latin America has not been taking advantage of the opportunities that have opened up during the current stage of demographic transition, when the working-age population is growing quite rapidly, and family dependency rates are dropping, thus facilitating the entry of more women into the labour market. This is reflected in the fact that while demographic growth fell from an annual rate of 2.7% in 1950-1980 to 1.7% in the 1990s, the economically active population grew at a fairly steady rate (2.7% in the earlier period and 2.6% in the 1990s). This should have made it possible to achieve much higher growth in per capita output in the recent past, just the opposite of the observed performance. Thus, it is clear that this "demographic bonus" is not captured automatically and, indeed, has not been captured in Latin America over the past two decades.

The considerable increase in the income gap between skilled and unskilled workers has been another widespread phenomenon (ECLAC, 1997; 2002a, chapter 10). As Table 5 indicates (see below), only a few countries have been able to avoid this trend. Detailed analysis indicates that it has been basically the result of the widening of the income gap between college-educated and other workers (Morley, 2001). The widespread character of this trend indicates that divergent specialization patterns within the region are not part of the explanation, but rather technological change and the relative growth of sectors (particularly some services) with high demands for human capital. Given these adverse trends, the greater participation of women in labor markets is the most positive pattern found across the region. In several countries, this has been accompanied by a reduction in the (still large) gender income gap.

2. Social spending and restructuring of social services

If trends in labor markets have been the most adverse social trend in Latin America, the most favorable has been increased social sector spending, which rose from 10.1% of GDP in 1990-1991 to 13.1% in 1998-1999, thus reaching the highest levels in the region's history (ECLAC, 2000a and 2000b). Also, the increase has been relatively faster in countries with lower per capita income, where social spending is usually smaller, as a reflection of their less developed social security systems. Uruguay and Brazil have strengthened their leadership in social spending, together with Argentina, Costa Rica and Panama. Colombia has been the only country moving from relatively low social spending to above-average levels, relative to the pattern of spending by per capita income levels (Figure 9). In any case, regional disparities remain large, and in several countries social spending remain clearly inadequate.

Figure 9
Per capita GDP and Social Spending



Source: ECLAC

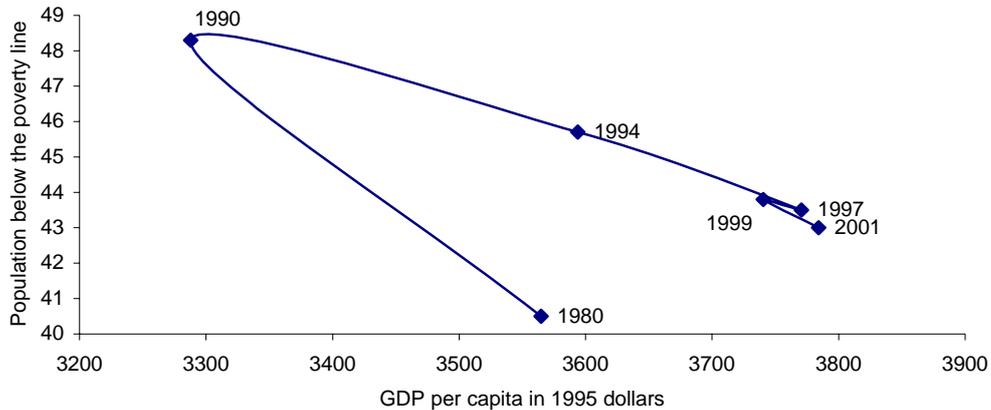
Increased spending has been accompanied by more selective allocation criteria (targeting), which takes into account the significant differences in the distributive impact of different types of spending (ECLAC, 2000a and 2000b). Changes have also been made in the way public resources are allocated, basically through more decentralized systems. Nevertheless, the efficiency and quality of social services continue to be low. Also, the coverage of different services does not always reflect rising spending and improved targeting, or the demands generated by modernization and equity. Thus, despite improved coverage of secondary education –slower, in any case, than that of competitors in East Asia–, disparities in access between the top and bottom quartiles increased over the past decade (ECLAC, 2002a, chapter 10). Also, as indicated, social security coverage has remained stagnant in most countries. Furthermore, problems relating to the differences in the quality of services received by different social sectors are probably on the rise.

In some countries, increased spending has led to the development of arrangements for private-sector participation in the provision of certain social services, particularly social security and low-income housing. This may have brought progress in terms of efficiency, including the use of equivalence criteria between contributions paid to the social security system and benefits received from it, but strong evidence in this regard is not available. In some cases, however, this has gone hand in hand with a concentration of private service providers in the higher-income, lower-risk sectors and a weakening of the principles of universality and solidarity that should be honored by social security systems (ECLAC, 2000a). It should be noted, however, that for the most part these principles were not properly applied in the region in the past, either, as reflected in the incomplete and segmented social security coverage during the period of state-led industrialization, including the proliferation of special arrangements that benefited certain social sectors.

3. Poverty and income distribution

Poverty shot up rapidly during the “lost decade” --from 40.5 to 48.3% of population-- and fell as growth recovered --to 43.5% in 1997--, though the number of poor stagnated at roughly 200 million. More importantly, the trajectory followed by the reduction of poverty was different to that which characterized the 1980s, indicating that the debt crises had adverse ratchet effects on poverty (Figure 10). Furthermore, positive trends in poverty were sharply interrupted during the "lost half-decade", generating indeed some additional 20 million poor persons. In recent years, whereas per-capita GDP has exceeded 1980 levels by some 6%, poverty remained three percentage points above pre-debt crisis levels. Furthermore, hard-core poverty, particularly in rural areas, has represented a significant challenge in all countries.

Figure 10
Poverty and per capita GDP



Source: ECLAC.

Success in reducing poverty has varied across the region. There are a few countries (Venezuela being the most remarkable case) where poverty rates are still higher than in 1990 (Table 5), and a larger group where they have not returned to pre-debt crises levels. Economic growth has been the most important factor in this regard. However, there are significant differences in performance relative to the average growth-poverty reduction pattern (Figure 11). Chile, which experienced the fastest rate of economic growth during the 1990s, also experienced a strong performance in terms of poverty reduction. Similarly, good performance in Costa Rica, and poor performance in Colombia and Honduras can be tracked down to differences in the rates of economic growth. Nonetheless, other countries show significant divergence from the average pattern: Uruguay and Brazil have done better than expected in terms of poverty reduction, whereas Argentina, Mexico and Venezuela have done much worse. Specific factors can explain deviation from the pattern, including the extensive system of social protection in Uruguay and the targeted minimum income policies in Brazil. The end of hyperinflation also had a positive

effect in all countries that had gone through that traumatic experience. Also, there is evidence that minimum wage policies also had a broadly positive effect in this regard.¹²

Table 5
Trends in poverty and income distribution

	Population below the poverty line		GINI coefficient		Relative poverty c/		Private sector wage gap	
	c. 1990	c. 1999	c. 1990	c. 1999	c. 1990	c. 1999	c. 1990	c. 1999
Argentina a/	21.2	19.7	0.501	0.542	39.1	44.2	2.14	2.47
Bolivia a/	53.1	48.8	0.538	0.586	44.1	45.5	3.46	2.90
Brazil	48.0	37.5	0.627	0.640	53.9	54.8	6.58	5.46
Chile	38.6	20.6	0.554	0.559	46.5	46.4	4.05	4.87
Colombia	56.1	54.9	0.601	0.572	48.9	46.6	2.59	3.82
Costa Rica	26.2	20.3	0.438	0.473	31.6	36.1	2.46	2.53
Ecuador a/	62.1	63.6	0.461	0.521	33.8	42.0	2.85	3.72
El Salvador b/	54.2	49.8	0.507	0.518	38.4	40.6	3.79	3.60
Guatemala	69.1	60.5	0.582	0.582	47.9	49.5	3.79	4.45
Honduras	80.5	79.7	0.615	0.564	52.3	46.4	5.13	3.34
Mexico	47.8	46.9	0.536	0.539	43.5	43.1	2.19	3.32
Nicaragua	73.6	69.9	0.582	0.584	45.9	45.9	2.53	2.76
Panama	42.8	30.2	0.560	0.557	46.4	46.4	2.93	3.14
Paraguay a/	42.0	49.0	0.447	0.565	33.4	46.3	2.75	3.62
Uruguay a/	17.8	9.4	0.492	0.440	36.8	32.2	2.45	3.14
Venezuela	40.0	49.4	0.471	0.498	35.5	38.6	2.12	3.32

Source: ECLAC (2001.)

a/ Urban area.

b/ Initial year: 1995.

c/ Percentage of population with per capita income below the 50% of the average income.

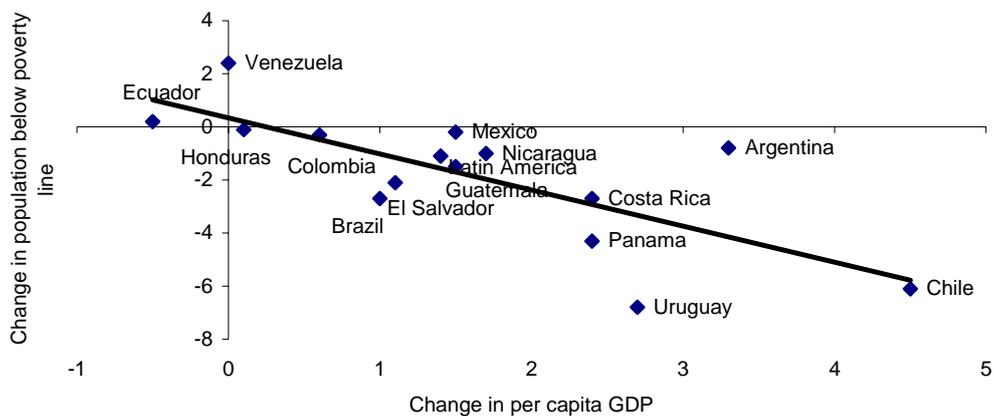
Unlike poverty, income distribution trends have been uneven across the region but, on the whole, show a tendency to deteriorate. There are several countries where income distribution, measured by either the Gini coefficient or relative poverty, experienced an adverse trend over the past decade and only a handful where the opposite is true --and some of these are debatable¹³ (see Table 5). Although comparing data on income distribution over long periods of time is a complex matter, there is no country in the region where inequalities have declined relative to what they were three decades ago and, on the contrary, in many countries inequality has increased. Uruguay is perhaps the only country in the region where falling levels of poverty in

¹² On the determinants of poverty, see ECLAC (1997, 2000a, 2000b, and 2001) and Morley (2001).

¹³ This is particularly the case of Honduras, where comparability of household surveys through time is a serious question, as well as Colombia, where urban income distribution has shown a clear deterioration but there is an improvement in rural distribution. Intertemporal comparability of household surveys in Paraguay, where Table 5 indicates a sharp increase in inequality through the 1990s, is also problematic.

the 1990s have been accompanied by a relatively equitable income distribution, but even there, distribution has not yet regained the favorable levels that it enjoyed thirty years ago. Although comparable household surveys are not available, Cuba probably enjoys the most equitable income distribution in the region, although it deteriorated as a result of the dramatic economic crisis it experienced in the early 1990s and the subsequent restructuring process, that was reflected in significant drops in per capita consumption.

Figure 11
Poverty reduction and per capita GDP growth, 1990-1999



Source: ECLAC.

ECLAC studies show that the inequalities are due to a combination of factors relating to education, demographics, employment and the distribution of wealth. As regards the first two, some progress was made during the 1990s. As noted, educational coverage increased, though there are signs of growing dispersion in the coverage and probably the quality of education among different groups of the population. Demographic dependence declined, but it remained an important factor in countries where there is a significant lag in the demographic transition. On the job front, however, there has been deterioration, as also indicated. The ongoing integration of

women into the labor market is one of the few factors that has had a broad positive effect on income distribution in most countries in the region, as well as in other areas of development. Not much is known about what has happened in terms of wealth inequality, but it is quite possible that there has been a worsening in this area as well.

In view of the increasing educational requirements for all occupations, progress in education has been clearly insufficient in terms of improving employment opportunities and earning power. From the standpoint of the labor market, diminishing returns from education have meant that only 47% of young people in urban areas and 28% in rural areas have improved their occupational outlook by increasing their educational level –relative to their parents-- above the also rising educational requirements in the job market. This is consistent with household surveys, which show that only half of Latin America's youth believe that they will enjoy better opportunities than their parents (ECLAC, 1998 and 2000b).

Furthermore, the increased demand for skilled labor defeated the favorable effects of improved coverage of secondary education on income distribution. As noted, one sign of this is the growing income gap between college-educated and other workers. In some countries, there has also been some narrowing of disparities between the incomes of workers who have received only primary education and those who have some secondary education, but this has been counterbalanced by greater dispersion of incomes among college-educated workers (Morley, 2001).

In broader analytical terms, there is considerable disagreement in the current literature as to why distribution has tended to deteriorate. Different studies focus on aspects such as structural reform, the debt crisis or more universal trends associated with technological and other factors

influencing wage skill differentials (see above).¹⁴ Berry (1998) stands out for his early emphasis on the adverse distributive effects of structural reforms, a hypothesis that has received increasing support in later research. In the light of the analysis in Section III, rising dualism is an important link between structural reforms and deterioration in income distribution, but other factors affecting income differentials --some of them worldwide in scope-- have also played a role.

In any case, recent adverse trends aggravated adverse distributive patterns that were already evident in Latin America in previous stages of development. Hence, the lack of equity is not just a characteristic of the recent reform period, but a pre-existing condition that reflects serious problems of social stratification that have been handed down from generation to generation (ECLAC, 2000a, 2000b).

V. THE WAY FORWARDS

As we look back at economic liberalization in Latin America, it becomes clear that the benefits of reforms were overstated and their risks minimized. Reforms were successful in many areas, particularly in bringing down inflation and generating credibility in the macroeconomic authorities, in inducing export growth and diversification, and in attracting foreign direct investment. But frustration also resulted from low and volatile growth, increasing dualism and, particularly, disappointing social outcomes. Some basic assumptions of reformers proved entirely wrong, particularly the assumptions that low inflation and more control on budget deficits would ensure stable access to international capital markets and dynamic growth, and that higher productivity in leading firms and sectors would automatically spread throughout the economy, leading to a broad acceleration of economic growth.

¹⁴ See, for example, Altimir (1997), Berry (1998), Morley (1995 and 2001), IDB (1997 and 1999), ECLAC (1997).

The interpretation of the poor outcomes of reforms remains highly controversial. One view explains these results as the effect of an insufficient commitment to the original reform agenda, and thus that the solution to the current frustrations is even more liberalization. An alternative view, much in vogue today, emphasizes that the original “Washington consensus” was an incomplete agenda, which must be complemented with a “second generation” of reforms, based on institutional and social development. Some proposals in this line of reasoning are ambitious and welcome (see, for example, Birdsall and de la Torre, 2001). Nonetheless, both approaches share a linear view of the reform process, failing to recognize that some of the basic assumptions of the process of liberalization were in fact wrong and, thus, that the first generation of reforms may have created some of the problems that we are facing today and, thus, that it is essential to “reform the reforms” (Ffrench-Davis, 2000; ECLAC, 2000a). Furthermore, the basic assumption of a unique “recipe” eliminates what is specific of institutional development and democracy: diversity and learning. Indeed, as we indicated in Section II.1, there has actually been more diversity in the reform process that is commonly recognized.

A more promising way to go is, thus, to acknowledge that it is essential to build on the positive aspects of the reform process, as well as the new agenda of institutional and social reforms, but also to correct the basic problems that the first generation of reforms has already evidenced. These problems lie in three basic areas: (1) the limited view of macroeconomic stability, which has resulted in pro-cyclical macroeconomic policies that enhance the effects of volatile external (particularly capital) markets, and thus generate an adverse investment climate as well as increased insecurity among social sectors; (2) the lack of recognition that building dynamic economic activities is not a mechanic outcome of the functioning of liberalized, open economies, and, even more, that productive and technological linkages between dynamic firms

and sectors and the rest of the economy are not automatic; and (3) that the social dimension must be effectively mainstreamed into the reforms process, particularly into macroeconomic, sectorial and microeconomic policies, and thus that successful social outcomes are not just an issue of complementary (and, in many cases, residual) social policies. Moreover, it must be explicitly recognized that there are diverse solutions to all of these problems, and that democracy must play an essential role in finding the appropriate policies for each particular context. This is the view defended by Rodrik (1999, 2001a, 2001b), ECLAC (2000a) and by this author (Ocampo, 2002a), among others.

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